



Nova Scotia

Report of the

AUDITOR GENERAL

March 31, 1986





Nova Scotia

Honourable A.R. Donahoe, Q.C.
Speaker
House of Assembly

I have the honour to submit herewith for the year ended March 31, 1986,
my Annual Report to the House of Assembly, in accordance with
Section 8 of the Auditor General Act.

Respectfully submitted

O.P. Cormier

O.P. Cormier, F.C.A.
Auditor General

Halifax, Nova Scotia
February 20, 1987



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INTRODUCTION

Introduction

In my 1986 Annual Report are two features which I believe readers will find worthwhile. One is the inclusion of a new section entitled "Status of Prior Years' Observations and Recommendations". This section is introduced to provide a reference indicating the status of observations and recommendations from the previous five Annual Reports. Most Provinces' Legislative Auditors include this type of summarization in their Annual Reports, and I believe it has proven useful.

The second is the reporting on two in-depth government-wide studies which we conducted during the year. One related to cash management, and the other to internal audit. In each of these assignments the objectives of the audit were broadened to encompass an evaluation of the function on a wider multi-department basis. We determined that there were significant matters in both which require attention. Accordingly we made substantive recommendations for consideration by the departments concerned.

Of real importance, however, is the fact that these two assignments provided a perspective on the management of government resources which cannot be obtained by a limited, single department focus. There were critical needs for policy direction, responsibility assignments, and specific resource allocations, all requisite for sound administration and management. In addition, it is worth noting that the reaction to our observations and recommendations by most of the departments concerned was quite positive. I am pleased, therefore, that our audit efforts contributed both to a comprehension of underlying weaknesses, and to an indication of appropriate corrective action.

I acknowledge Government's introduction of an intensive strategic planning review of its program delivery process, and I commend them for this initiative. I trust that their efforts will be successful, and result in more efficient and effective program delivery and resource utilization.

In my two previous Reports were articles on the topic of accountability. Within these discussions I presented an extensive treatment of matters concerning the independence of this Office, and the scope of its audit activity. I suggested amendments to the provisions of the Auditor General Act, and commented on the role of the Public

Accounts Committee and its relationship with the Auditor General. These are again dealt with, because many of the concerns previously expressed still remain.

There is an article relating to the financial position of the Province and its operating results. This year we have expanded the commentary by the inclusion of certain interprovincial comparisons, and graphic presentations, which should improve the degree of understanding of this critical area.

* * * * *

The mode of reporting for my Annual Report is one which might be termed "reporting by exception". It is necessary to comply with reporting requirements of Section 8 of the Auditor General Act, as well as those which flow from Sections 7 and 16. Accordingly, the preponderance of audit findings and comments included are of a nature which point to shortcomings and weaknesses, and indicate suggested corrective action.

However, I would like to repeat the comment I made each of the last two years, to the effect that the majority of our departmental audit reports contain positive findings and conclusions resulting from our audit assignments. To provide a more complete perspective of our audit activities during the year, included in this Report as Appendices II and III, are listings of all audits we performed. By comparing the extent of the commentaries found in the three sections relating to crown agency audits, special departmental reviews, and other audit observations with the 78 audits listed in these two appendices, the reader can conclude that the majority of our audits did not result in reportable findings and conclusions.

* * * * *

Again it is my pleasure to acknowledge the excellent cooperation extended to our audit staff in the performance of their audit assignments by the officials and staff of government departments and agencies. In addition, I would like to express my gratitude for the assistance provided us in our various administrative activities. This year in particular, I would like to single out the efforts of the Department of Government Services regarding our recent move of office premises. The Department of Finance and the Systems and Computer Services Division of the Department of Government Services have continued their high degree

of support essential to the efficient performance of our audits in various departments and agencies. Management Board, Civil Service Commission and the Government Purchasing Agency have also been highly supportive to our office.

It is again my pleasure to recognize the excellent performance of the audit and administrative staff of this Office. Our audit activities are continually evolving into more extensive and complex assignments. Staff's ability to effectively complete these is a tribute to their professional and personal capabilities.

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SUMMARY

Summary — 1986 Annual Report

This summary presents the principal matters dealt with in the Report. It notes key observations, conclusions and recommendations, but does not include all matters to be found in the Report.

Audit Responsibilities

The auditing and reporting responsibilities of this Office, as mandated by Sections 7, 8 and 16 of the Auditor General Act are described here. The extent or scope of the audit examinations carried out during the year are summarized.

Government Resources — Accountability and Management

This section is a continuation of the discussion introduced in each of the previous two Annual Reports, dealing with the Accountability Process. The four steps in this process — the Estimates, the Public Accounts, the Audit Function and the Review by a Committee of the Legislature, are each treated separately in terms of how well each, in my view, fulfills its role in the process.

Three significant matters are again raised:

- the need for revisions to the Auditor General Act, primarily to ensure a proper degree of independence for the position;
- the desirability of legislating a broader scope of audit activity, especially concerning the right to perform reviews where government grants and other assistance have been provided; and
- suggestions for improvements in the functioning of the Public Accounts Committee.

As a result of two special assignments, of a government-wide nature, this section of the Report has been extended to deal with matters relating to overall management within Government. An acknowledgement of various initiatives undertaken by Government directed towards better management is presented. In particular, the recently commenced Strategic Planning Process is noted and commended.

The two assignments, one on performance of the cash management function and the other a study of internal audit, resulted in three significant observations.

- The need for government-wide policy statements with respect to implementation of sound cash management practices, and the utilization of internal audit.
- A requirement for functional guidance and support in each of these two areas.
- The creation of a monitoring or control mechanism to ensure all departments understand, implement, and adhere to policy directives.

Financial Position and Operating Results

This section deals with such matters as the Province's net debt, its annual operating results, and comments on selected expenditure items. In this year's article, there is an expansion of the coverage by the use of graphs, more data, and some interprovincial comparisons.

Again this year there has been an excessive number of additional appropriations approved well after the fiscal year end, after the expenditure has taken place.

Four of the more significant observations from this section are:

- The size of both the Province's debt and its annual operating deficit continue to be of serious concern to me.
- There should be a viable long-range plan for reducing the deficit, which can be translated into realistic annual plans.
- Government and taxpayers alike must recognize that, because of the Province's existing financial position, all demands cannot be met. Spending requests will have to be realistically prioritized.
- Regarding additional appropriations, there is clear need for improvements in either the accounting and control routines in the departments, or for a greater degree of attention to these matters by those responsible.

Crown Agencies and Corporations

I review the auditors' reports on those crown agencies and corporations not audited by our Office. There was nothing of consequence to report from this review.

I have noted the need for legislation to apply to all crown agencies and corporations, that would codify certain requirements relating to accountability and disclosure of their operating results.

Two special audits were conducted this year in crown agencies where I am not the appointed auditor. One was at Sydney Steel Corporation, the primary purpose of which was to obtain a general appreciation of the current situation at the Corporation, and also to assess management and control over selected areas. The other was at the Nova Scotia Liquor License Board, to review its four divisions from an operational standpoint. In both, our conclusions were favourable regarding management of these crown agencies.

At Sydney Steel Corporation, our review included familiarization with the problems regarding continuation of the modernization program. It was not our intent, from either a responsibility or expertise standpoint, to arrive at a point of view concerning the decision. At the completion of our audit, a final resolution of the matter had not been made.

Concerning the Liquor License Board, we concluded that its operation was being appropriately administered, and we made recommendations relating to annual reporting and annual budgeting matters.

Special Department Reviews

Some of the most extensive, and I would add worthwhile, audit endeavours of the past year involved two government-wide special reviews — on cash management and internal audit.

Our review of the cash management function across government revealed a condition which we viewed with some concern. There is a lack of appropriate policy and procedure, staffing and responsibility, and a general lack of awareness of the need and benefits of a sound cash management function. Accordingly, there are substantial additional costs and lost income which we have estimated to be at least \$1 million annually.

We made specific recommendations concerning:

- management and forecasting of cash flow;
- administration of banking arrangements; and
- the payment of accounts function.

We reviewed the performance of and need for internal audit in all departments of government. It was found to be operating fairly well in five departments. In four others without it, we concluded there is a critical need for it. For eight smaller departments a type of shared internal audit capability has been suggested. In addition, we recommended that a greater emphasis be placed on audit review for economic and efficient use of resources, and also that there be developed an overall policy statement on the role and responsibilities of internal audit throughout government.

A third extensive review was of the vocational schools operation in government. We examined management control systems, administrative procedures for curriculum development and certain aspects of staff administration, and facilities and materiel management. We visited six vocational schools. Our review resulted in recommendations concerning an enhanced data analysis process for better management control, and improved procedures for both curriculum administration and human resource management.

In addition we completed the following other special audits.

- Attorney General — This year we audited a second group of public officials, namely the County Sheriffs operation. We found no serious control deficiencies, but did point out some matters requiring attention, which included systems deficiencies and non-compliance with department policies and procedures.
- Government Purchasing Agency — We completed the second phase of our audit commenced in 1985. The focus this year was on the Agency's systems and procedures for acquisition of goods and services at fair and reasonable prices, including its area buying and buy Nova Scotia practices. Our conclusion was that generally prices paid were fair and reasonable and the additional cost of these two practices was not excessive.

Prudent application of the "area buying" and "buy Nova Scotia" purchasing policies must continue to ensure that unduly high prices are not paid in support of these initiatives.

- **Health** — We did a brief update relating to an audit we performed in 1984 regarding the process utilized to review hospitals' final settlements, and found significant improvements had been implemented.
- **Expenses of Members, Ministers, Deputy Ministers, Ministerial Assistants, and Judges of the Provincial Magistrate's Court** — The purposes of this audit were to assess the adequacy of relevant regulations and guidelines for these expenses; to evaluate the approval and checking functions in the Speaker's Office and the Department of Finance; and to determine how well the regulations and guidelines were being adhered to and contentious matters resolved. I am pleased to report that we derived favourable conclusions regarding all of these objectives.

Other Audit Observations

The audits performed by my Office are found in Appendices II and III which tabulate the 45 audits in 19 departments and the 33 financial statement opinion audits, completed during the current audit year. This section of the Report may be termed the "reporting by exception" discussed briefly in the Introduction. Some of the more significant matters are the following.

Cash and other losses — As a result of our review of these losses, I again point out the need for a revised Management Manual bulletin dealing with actual or suspected losses involving fraud.

Computer related audits — During the past year we performed update reviews of computer controls and systems at five agencies and departments, carried out brief status reviews of two major systems under development, and audited two of the Province's major computer sites — the Departments of Finance and Social Services.

Improvements have been made in the overall level of controls over computer resources and systems. However, further efforts are required to enhance and maintain both the level and consistency of controls throughout the Province's computer operations.

A number of significant systems are being developed or planned which will result in more decentralized use of processing capabilities by departments and agencies. As a result, integrity of the security and controls over computer systems, including adequate disaster recovery and contingency plans, will continue to be a critical concern.

Department of Development — Agreements approved by Order in Council, if changed, should have revisions ratified by a subsequent Order.

Provincial Retirement Plans — The Auditor General has the responsibility each year to audit both the Public Service Superannuation Fund and the Nova Scotia Teachers' Pension Fund. A qualified actuary has the responsibility for assessing each fund's position in relation to future pension commitments. In view of the importance of future pension commitments, it has been customary to comment each time that an actuarial valuation is performed. An actuarial report was submitted in 1986 for the Teachers' Pension Fund. In the article on this topic, I express serious concerns regarding the size of the unfunded liability, and the fact the current contributions do not cover the cost of benefits being earned. As well, I recommend steps be taken to provide for a more frequent actuarial valuation than once every five years.

Reservations of Opinion — There was evidence of substantial weaknesses in the accounting controls for four audits we performed, to such an extent that it was necessary to qualify my audit opinion regarding them. The most serious of these related to the financial statements of the Public Trustee, where the accounting and control systems for certain assets under administration are seriously deficient.

Venture Corporations Board — The results of a recently completed study by a firm of chartered accountants are summarized. I reiterate comments made last year to the effect that continuing intensive monitoring of the Board's equity loans is necessary, and that compliance with certain provisions of the Venture Corporations Act be enforced.

Status Prior Years' Observations and Recommendations

There is presented for the first time a tabulation of observations and recommendations from prior years' Reports. This tabulation, covering the five years 1981 to 1985 inclusive, indicates the status of 54 items. It is worth noting that for 22 of these, the situation still maintains and/or the recommendation has not been implemented. A more formal follow-up process, a suggested role for the Public Accounts Committee, is worthy of consideration.

Office of the Auditor General

This section includes information on staffing, financial results, various professional and training activities of the Office, and other related matters.

Appendices

One Appendix reproduces certain relevant sections of the Auditor General Act. The other three tabulate audits done by my Office, and those performed by private sector auditors.

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**AUDIT
RESPONSIBILITIES**

Legislative Requirements

The responsibility for audit of the accounts of the Province by the Auditor General is set forth in Section 7 of the Auditor General Act. The Auditor General is required to examine, in such manner and to the extent he considers necessary, accounts relating to both money received and money expended, and to ascertain whether in his opinion:

- all public money has been fully accounted for;
- money has been expended for the purposes for which it was appropriated by the Legislature;
- the accounts have been properly kept; and
- essential records and procedures are maintained to safeguard and control public property.

The annual reporting requirement of the Auditor General to the House of Assembly is found in Section 8 of the Act. There must be brought to the attention of the House every case in which he has observed that:

- any person has willfully or negligently omitted to collect or receive money belonging to the Province;
- public money was not fully accounted for and paid into the Consolidated Fund;
- any appropriation was exceeded or applied to a purpose or in a manner not authorized by the Legislature;
- an expenditure was not authorized or properly vouched or certified;
- there has been a deficiency or loss through fraud, default or mistake of any person;
- a special warrant authorized the payment of money; and
- any other case that the Auditor General considers should be brought to the notice of the House.

Sections 7 and 8 of the Auditor General Act are reproduced as Appendix I of this Report.

Scope of Examination

The scope of audit activity for my Office can be classified under five distinct headings, each of which is described in the following paragraphs.

1) *Auditor General Act, Section 7 Requirement*

To meet the legislated requirements of Section 7, my Office conducts reviews of the accounting systems, controls, and transactions within the departments of government. These reviews involve tests of systems, accounting records, and other supporting evidence.

All systems in every department are not subject to annual audit. Although the audit work undertaken is selective, it encompasses sufficient activity in major departments to fulfill the mandate prescribed in Section 7.

To provide a perspective regarding the extent of the Office's auditing in the departments of government, a listing of the 45 audits in 19 departments performed in the past year is in Appendix II of this Report.

Those topics reported in "Other Audit Observations" beginning on page 110, represent matters from the audits on this listing for which there is a reporting requirement under the Auditor General Act. Comparison of the number of topics dealt with in this Report with the number of audits performed will indicate that only a small portion resulted in findings having to be reported to the House.

2) *Audits of Crown Agencies*

The Auditor General is the auditor of 33 crown corporations, boards, commissions, and funds. These appointments flow from the Acts of the entities, Order in Council appointments, or appointments made by the Boards of the entities. In each case, it is my responsibility to express an opinion on the annual financial statements of the entity.

A schedule of these audits may be found as Appendix III of this Report. Most of these financial statements are published in the Public Accounts of the Province.

3) *Audits by Other Chartered Accountants*

There are other crown agencies and corporations, whose annual audit is performed by a chartered accountant other than the Auditor General. A schedule of these may be found as Appendix IV.

Under Section 16 of the Auditor General Act, I am provided annually with the audited financial statements, and all reports prepared by the auditors of these agencies and corporations. A summary of our review of these reports is found in the article on page 56. In addition, the Auditor General may conduct such additional examination and investigation of the records and operations of the agency as he deems necessary.

Since this provision was legislated in 1973, it has not been possible to conduct additional reviews in all these agencies and corporations. In 1985, my Office prepared a five year plan providing for a minimum of one audit examination in each crown agency and corporation during that period. These examinations will encompass reviews of selected aspects of their operations. During 1986, examinations were completed at the Nova Scotia Liquor License Board, and the Sydney Steel Corporation. These are reported upon separately on pages 58 and 60.

4) *Other Audit Assignments*

In addition to audit examinations performed under the Section 16 mandate, my Office usually conducts one or more special audit reviews of departments, crown agencies, or corporations under Section 7 of the Auditor General Act. These assignments may be an in-depth review of a given segment or program of a department or agency, or a review of a function that is performed in several departments, referred to as a government-wide or horizontal study.

There were six such assignments performed in the current year, each of which is presented in this Report.

Department of Attorney General —	
Sheriffs	(page 71)
Cash Management	(page 74)
Government Purchasing Agency	(page 87)
Internal Audit	(page 92)
Travel Expenses	(page 98)
Department of Vocational and Technical	
Training — Vocational Schools	(page 102)

In addition, as an update to our 1984 assignment, a review of the "final settlement process" of the Department of Health was undertaken and is reported on page 91.

5) *Federal Provincial Cost Sharing Claims*

My Office has the responsibility to certify claims for various cost sharing programs of the Province with the Government of Canada. For the fiscal year ended March 31, 1986, a total of 353 claims were audited, relating to 12 separate agreements involving 71 projects.

It is our responsibility to determine that the terms of the agreements have been complied with by the departments concerned, and that the amounts claimed are in accordance with the agreements.

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**GOVERNMENT RESOURCES
ACCOUNTABILITY
AND
MANAGEMENT**

Introduction

My two previous Annual Reports included articles describing each of the four steps in the accountability process, namely the Estimates, the Public Accounts, the audit function, and the Public Accounts Committee. The principal reason for my presentations on this topic was to explain more fully, and thereby enhance an understanding of, the role of the Office of the Auditor General.

In fulfilling the responsibilities of a legislative audit office, we concern ourselves with the adequacy of management controls and systems. Unless these controls and systems are properly conceived in the first instance, and working effectively for management, government resources will not be administered to their optimal degree.

As a result of two special assignments, of a government-wide nature, conducted by my Office during the past year, I am extending the article on accountability to deal with matters relating to overall management within Government. These assignments, one on performance of the cash management function, and the other a study of internal audit, have provided a perspective which is not normally achieved in the conduct of our more restrictive single department audits.

Accordingly, we have derived both observations and conclusions for certain policy requirements and organizational realignments to be considered by Government. It is my view that more effective management of Government resources can be effected by implementation of our recommendations. These will be described more fully in the second part of this article.

First, I shall discuss each of the four elements of the accountability process, to indicate items outstanding from prior years, and to introduce some relevant new material.

The Accountability Process

Estimates

The Estimates are the first step in the accountability process, and as the foundation for the other stages may well be considered the most important. The Estimates summarize the Government's financial plan for the fiscal year and include revenue, operating, and capital expenditure programs. They are presented to the House for debate and vote, and included each year in the annual Statutes.

My previous Annual Reports have included commentaries on the mode of presentation and the detail included in the Estimates. The Government has been commended for its logical, well organized budget submission which contains appropriate detail for analysis and understanding of the activities and programs of government departments.

It is essential that the Estimates accurately reflect planned spending of Government for the upcoming fiscal year. I acknowledge that unforeseen circumstances will arise requiring modifications to the approved spending Estimates. However, every effort must be made in the first instance to have the Estimates as complete as possible. In the article on Additional Appropriations, page 50, there is reference to the fact that the budgets for three items in the 1985-86 Estimates did not appear to realistically anticipate the actual that was subsequently incurred.

In my 1985 Report, there were comments relating to the use of performance or results indicators, which are employed to measure the efficiency of program expenditures by relating activity to some quantitative measure. I encouraged Government to extend the application of these techniques. They are of benefit in identifying areas of excess capacity, and inefficient administration or delivery of services. To effect economies in operations, these indicators must be used extensively for analysis, and identification of inefficiencies, so that appropriate corrective action can be initiated.

Public Accounts

The Public Accounts, as the Province's Annual Report on its financial stewardship, include financial statements for the fiscal year for the Province, as well as for crown agencies, corporations and funds, details on departmental expenditures and recoveries by principal function and program, and a supplementary volume detailing information on various departmental expenditures.

This Office is the only legislative audit office in Canada which does not have the responsibility for expressing a formal audit opinion on its Province's financial statements. However, we do review them and have been able to state in our Annual Reports since 1983, on the basis of this review and our knowledge of the accounting and disclosure practices being followed, that the financial statements for the fiscal year are an appropriate presentation of the Province's financial position and operating results.

There are three items from last year's Report which warrant brief comment.

- The Public Accounts still use forecast data in the Statement of Current Revenue and Expenditure, which in my view, is both irrelevant and unnecessary.
- I had suggested in my 1984 Annual Report the need for a more detailed disclosure of expenses of the Members of the House of Assembly. This disclosure will be effected in the Supplement to the Public Accounts for the 1986 fiscal year.
- The Statement of Financial Position of the Province includes among its assets a non-realizable advance, namely the \$69.7 million under the Universities Assistance Act. These advances are not recovered directly from the universities, but rather are forgiven by the Province and charged to current expenditures each year and do not, in my view, qualify as realizable recoveries from outside parties, but are merely cost deferments. Accordingly, they should not be included among other recoverable assets on the Province's Statement of Financial Position.

Audit

In each of the past two Annual Reports, articles on the audit function have been concerned with the need to place this Office in a position from which it can fulfill its role in the accountability process in a manner comparable with most other legislative audit offices, and appropriate to the specific requirements in Nova Scotia. Two significant issues have been emphasized, which are the independence of the Office, and the scope of audit activity. I have suggested the need for amendments to the Auditor General Act in order to alleviate concerns which I have relating to these two matters.

In late calendar year 1985, I presented Government with a formal submission containing proposed amendments, together with explanatory and supportive comments. Unfortunately Government was not in a position to act on these suggestions during the 1986 sitting of the House. I submitted a revised presentation in late 1986 reflecting some minor revisions but essentially requesting consideration of certain basic issues relating to this Office. These are described briefly in the following two paragraphs.

To ensure the organization and resources of this Office are adequate to meet the requirements of its legislation and the needs of the Legislature, the Office should not be subject to any possible constraints by those who are audited by the Auditor General. A degree of independence has to be maintained, which can best be achieved by some degree of reporting to a Committee of the Legislature. It has been suggested that this Committee have a variety of functions including an overview of administration and budgetary matters; and ensuring there is an annual expenditure audit, and a periodic review of the performance of the audit function. This Committee should have a role in the appointment of both the Auditor General and the Deputy Auditor General, to ensure that these persons are acceptable to the Legislature from whom their mandate flows.

The scope of audit activity of the Office of the Auditor General is critical to performance of its role in the accountability process. Perhaps the most important need is for a legislative audit mandate to perform reviews where government grants and other assistance have been provided. Nearly 70% of the Province's expenditures relate to grants and assistance provided individuals, institutions, corporations and organizations. It should be evident that there must be, as presently there is not, an opportunity for audit and examination of the recipient's operations to ensure that payments from Government are used as intended, and spent in an economical, efficient and effective manner.

In addition, there should be a clear enunciation of the mandate of this Office to perform the broader scope type of audits in both crown agencies and departments. These have been conducted on a regular basis for many years and there are several reported upon this year.

Finally, it would seem appropriate to reconsider the responsibility for the audit opinion on the financial statements of Government. Nova Scotia is the only Province in Canada which engages a public accounting firm to attest to its financial statements. It is my view that as well as eliminating a significant duplication of audit effort at substantial cost saving, a more independent accounting to the Legislature would be implemented by having our Office assume this responsibility.

Public Accounts Committee

Prior years' commentaries on this, the fourth step in the accountability process, have centered on the desirability of certain improvements in the organization and procedures used by the Public Accounts Committee, to facilitate a more effective working relationship with the Office of the Auditor General. I will be providing the House of Assembly Special Committee on Rules and Procedures with the results of a survey I performed in 1986, relating to the organization and practices of other Public Accounts Committees in Canada. The purpose of this submission will be to assist the Committee in its deliberations regarding roles, rules, and procedures for all Committees of the House.

For the 1987 sitting of the House of Assembly, there will be an Opposition Member as Chairman of the Public Accounts Committee, a step previously advocated by this Office. Of equal importance, if not more so, in enhancing the effectiveness of this Committee, are four items which this Office has suggested for consideration in previous Annual Reports. These are the need for a more formal enunciation of the role and responsibilities of the Committee; the use of formal agendas and the provision of required background material to facilitate discussions at meetings; the preparation of a substantive report annually to the House of Assembly; and the scheduling of Committee meetings other than when the House is sitting.

Management of Government Resources

In this section of the article I would like to deal with the observations emanating from the two special audit assignments on cash management and internal audit. First, a commentary on various initiatives of Government in recent years towards the implementation of more effective management systems.

Government Initiatives

There have been some extremely worthwhile and forward thinking initiatives undertaken by Government directed towards better management of the departments and agencies which comprise the total Government entity. Some of these are:

- the adoption of the "Management Planning and Budgeting System" which culminated in the vastly improved set of annual Estimates;
- the realignment of certain functions among several departments to obtain a more coordinated and logical department structure;
- various initiatives with respect to personnel management, including the introduction of revised classification methods and the introduction of a middle management professional development program;
- a rationalization of computer resource management by the formation of the EDP Advisory Committee, and the introduction of long-range systems planning; and
- the publication by Management Board of a series of Management Manuals in several key areas such as overall management, personnel management, and budgeting and financial management, which include policies, procedures and recommended operating practices.

These accomplishments are indicative of a positive approach directed to the objective of improving the management process in Government.

A more recent development, and one deserving of particular mention, is the Strategic Planning Process Initiative announced in December 1986. In order to attain the best value from government resources and activities, this planning initiative was undertaken with a view to identifying areas where improvement is desired, and to build upon and make maximum use of existing strengths and resources. This is being done so that policy, program and service decisions will be made on a basis of need, value and affordability.

Planning may be viewed as the most important phase of the management process, because all else flows from it in the administration and execution of programs and services. Accordingly, this Strategic Planning exercise may well prove to be Government's most useful initiative in fulfilling its management responsibilities. Reaction to the completion of early phases in this process has been quite favourable, and I trust that the entire process will be completed successfully.

There are two matters which should be expressed prior to a discussion of the specific observations derived from our special audit assignments. The conditions described in each area are ones which have existed in the departments concerned for some time, and are not to be interpreted as recent developments. The observations and conclusions we offer should be considered in the context of an ongoing continuum of management development and improvement. Also, implementation of recommended changes will take time to be accepted and understood, and to become fully operational and effective.

Audit Observations

The results of two special assignments, namely cash management and internal audit, are described more fully in other articles in this Report. It should suffice here to highlight the matters which relate to management, so as to provide illustrations in support of the conclusions and recommendations in the final section of this article.

As a result of our audit of the internal audit function in all departments of government, we derived two basic conclusions. There is need for an overall policy statement on the role of internal audit throughout government; and need for an expanded scope by internal auditors to include reviews of the economic and efficient use of resources.

These two conclusions are based upon audit reviews which showed:

- a critical need for an internal audit function as part of the management control process in four fairly large departments;
- in all departments, the lack of long range audit planning to ensure adequate cyclical coverage of important and material areas; and
- a preoccupation with financial and compliance matters, with little if any attention being paid to resource management concerns.

The cash management study, performed in several key departments of government, indicated a lack of formal cash management policies and accepted practices appropriate to an organization of the size and complexity of the Province. We found varying degrees of awareness of contemporary techniques for sound cash management, with the result that current practices were seriously deficient. As a result, substantial cost savings were missed.

Conclusions and Recommendations

It is my contention that there are three issues of significance flowing from the foregoing audit observations, which can be briefly described as follows.

- There is a need for policy statements to be developed that for all departments will prescribe requirements with respect to the utilization of an internal audit function as part of the management structure, and the implementation of sound cash management practices.
- There is also a need for functional guidance and support in these two areas, because of the specialized nature of each.
- In view of the size and diversity of the various departments of Government, it would seem prudent to recommend for consideration the creation of some type of monitoring or control mechanism to ensure all departments understand, are capable of implementing, and are adhering to policy directives.

This latter suggestion is one that I present with some degree of caution because of the risk of misinterpretation. I recognize that each department has its own responsibilities to fulfill in terms of the services and programs it offers. Each is somewhat unique and specialized, and therefore requires the degree of expertise which will be found in individual departments.

However, there appears to be a need for a central body, likely Management Board, to ensure that the management practices followed in individual departments are in compliance with government-wide policies; consistent, although not necessarily in all respects identical, throughout; and most importantly, geared to providing the most effective management possible of the resources entrusted to a given department.

This type of responsibility and overall surveillance would not be restricted to merely cash management and internal audit. It would, and to some extent already does, include such areas as budgeting, financial reporting, and computer resource management. It should also include human resource management in all its aspects — recruitment, evaluation, and training and development. There is also the likelihood of certain across-the-board requirements from the strategic planning initiative mentioned previously.

I trust the foregoing will not be considered as an unwarranted intrusion by the Auditor General into matters which might be interpreted as ones of policy, and not his responsibility to comment upon. However, I reiterate that our audit efforts, taken within the context of other work of this Office over recent years, would seem to point to the need for required policy directives in certain key areas. Moreover, there would appear to be a requirement for the assumption of responsibility to ensure these policies are being followed. This responsibility may best be assumed by a central management group such as Management Board, from which many overall policy directives currently emanate, and who already have the enunciated responsibility to act for Executive Council on matters relating to the management of the internal operations of Government.

* * * * *

FINANCIAL TOPICS

Financial Position and Operating Results

In each of my last two Annual Reports, I commented on certain relationships and trends pertaining to the financial position and operating results of the Province. Those comments stressed the impact of continuous operating deficits and the ever-increasing debt load.

I described several key measures which could be utilized to analyze the financial position and operating results of the Province. Again this year, my comments are based on these measures and, for the first time, include comparisons of certain key ratios and trends with those of other provinces.

Net Debt

The most commonly used indicator of a province's financial position is its net debt. In the Public Accounts, the Statement of Financial Position highlights this amount, which is the excess of liabilities over realizable assets.

The net debt of the Province was \$3.2 billion on March 31, 1986, which represents an increase of \$.5 billion or 18.5% since March 31, 1985. Ten years prior, on March 31, 1976, the net debt of the Province was \$374 million. During the past decade, therefore, it has increased to more than eight times its 1976 level. This increase of \$2.9 billion is attributable to:

Capital expenditures	\$1.6 billion
Net excess of operating expenditures over operating revenues	<u>1.8 billion</u>
	3.4 billion
Less: Sinking fund earnings	<u>.5 billion</u>
	<u>\$2.9 billion</u>

Provisions for sinking fund installments and serial retirements of \$431 million over this period are not included in the above tabulation. It will be noted that approximately 53% of the increase in the net debt over the 10 years has been caused by the operating deficits of the period, while 47% has been attributable to capital expenditures. This situation is similar to an individual who borrows to buy groceries and pay the rent each month as well as to purchase capital items such as a car.

To understand the significance of the \$3.2 billion net debt of the Province and to compare the financial position with the other provinces, it is necessary to examine net debt on a per capita basis, as a percentage of the total personal income of the Province (before tax), and as a percentage of the gross domestic product. Exhibit I graphically depicts the growth of the net debt over the past 10 years. The figures for net debt per capita, net debt as a percentage of total personal income (before tax) and net debt as a percentage of gross domestic product have been inserted on the graph.

Exhibit II compares the net debt of Nova Scotia with that of the other provinces for the 1984-85 fiscal year.

In both areas compared (net debt per capita and net debt as a percentage of gross domestic product), Nova Scotia was the second highest. Since 1982, the only province which has had a consistently higher net debt per capita, as a percentage of total personal income and as a percentage of gross domestic product, is Newfoundland.

Operating deficit

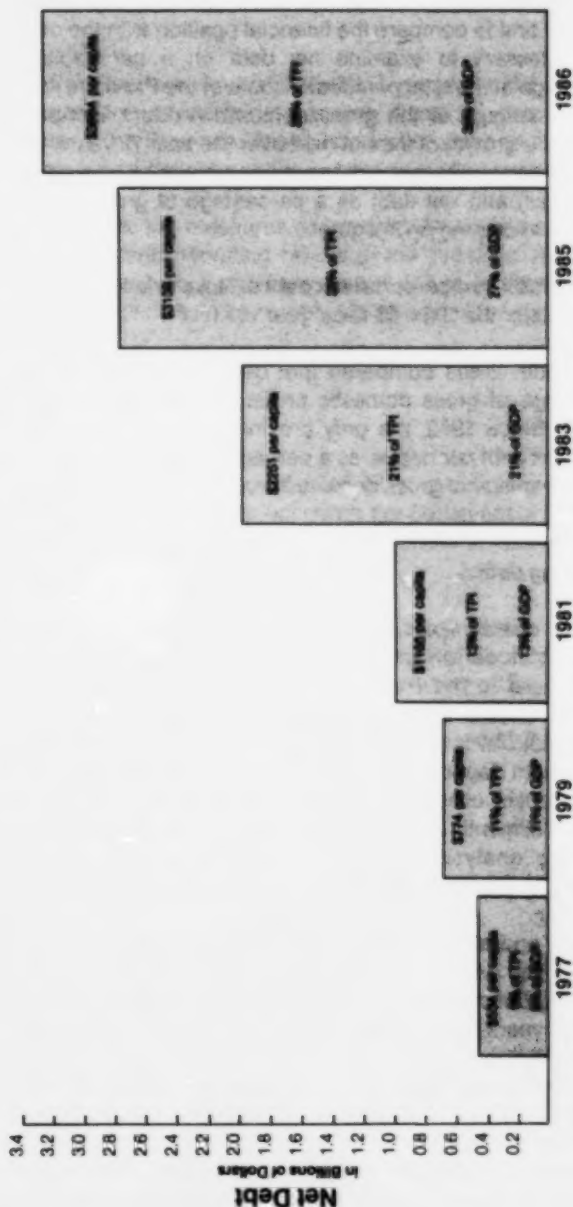
The operating deficit or surplus for the year is the second measure of financial performance. The Statement of Current Revenue and Expenditure in the Public Accounts shows this amount next to the caption "Excess of Current Operating Expenditure over Revenue and Recoveries". It is the excess of the total current expenditures for all government departments, plus grant and assistance programs and debt service costs, over the total of operating revenues for the year. Sinking fund installments and serial retirements have been excluded from the following analysis because in government, as in business, debt repayment is not a part of profit and loss determination.

The operating deficit for the fiscal year ended March 31, 1986 was \$252 million which is an increase of \$32 million or 14% over the 1985 operating deficit. The operating deficit or surplus of the Province during selected years over the past ten years is shown on Exhibit III.

The Province also incurred capital expenditures during the year. These include expenditures for highways, construction and expansion of government buildings, equipment, and grants for both buildings and equipment for hospitals and other institutions. Capital expenditures are not included in the calculation of the current year's operating deficit but

Exhibit I

Net Debt



GDP = Gross Domestic Product of the Province of Nova Scotia
 TPI = Total Personal Income (before tax) of the Province of Nova Scotia

Sources: Gross Domestic Product and Total Personal Income —

1977-1983: Statistics Canada
 1985 and 1986: The Conference Board of Canada Forecasts of Key Economic Indicators
 Population — Statistics Canada

Exhibit II

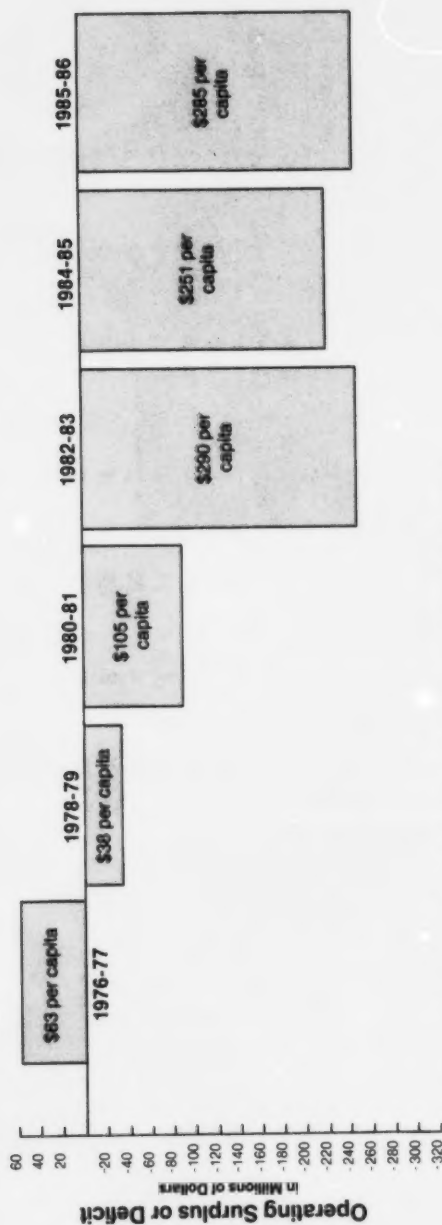
Interprovincial Comparison of Financial Position and Operating Results
For the year ended March 31, 1985

	Net Debt (Equity)			Deficit (Surplus) for the Year (including capital expenditures)		
	\$ Per Capita	Rank	% of GDP	\$ Per Capita	Rank	% of GDP
Nova Scotia	3,138	2	27	515	1	4
Newfoundland	4,017	1	41	425	5	4
Prince Edward Island	1,025	7	11	193	9	2
New Brunswick	2,736	4	25	466	3	4
Quebec	3,078	3	22	490	2	4
Ontario	2,527	5	14	295	8	2
Manitoba	2,116	6	14	453	4	3
Saskatchewan	64	9	.4	372	6	2
Alberta	(6,702)	10	(24)	(809)	10	(3)
British Columbia	546	8	3	342	7	2
Canadian Average	1,255		13	274		2

Sources: Gross Domestic Product — The Conference Board of Canada
 Forecasts of Key Economic Indicators
 Population — Statistics Canada

Exhibit III

Operating Surplus or Deficit



Note: Operating Surplus or Deficit excludes sinking fund instalments and serial retirements.

Source: Population — Statistics Canada

they do serve to increase the Province's net debt. During the fiscal year ended March 31, 1986, capital expenditures of the Province were \$192 million, a 17% decrease from the 1985 figure.

A comparison of the operating deficit of the Province with that of other provinces for the 1984-85 fiscal year is shown on Exhibit II. Capital expenditures were added to the current expenditures for this comparison in order to make the figures for the various provinces comparable. This table shows that on a per capita basis, Nova Scotia had the highest operating deficit of all provinces for the 1984-85 fiscal year. Since 1982, only Newfoundland and New Brunswick have had higher operating deficits on a per capita basis, or as a percentage of gross domestic product.

Exhibit IV shows the total revenues and recoveries together with the total current expenditures of the Province over the past 10 years. This graph demonstrates that expenditures increased at a faster rate than revenues over this period. This disparity in growth rates accounts for the increasing operating deficit and the growing net debt.

Revenues and Expenditures

To provide further understanding of operating results, it is necessary to examine the trend of significant revenue and expenditure amounts. Exhibit V shows by major category the revenues of the Province for the current year, the previous year, five years and ten years ago; while Exhibit VI shows the expenditures by major category over the same time period. Both charts include per capita and percentage of gross domestic product figures.

The effect of the ever-increasing debt load of the Province on debt servicing costs and total expenditures is apparent on Exhibit VI. The 1985-86 debt charges of \$539 million increased by \$68 million or 14.5% over 1984-85. The 1985-86 figure represents a 520% increase over the debt charges of 1975-76. As debt servicing costs become a higher percentage of total expenditures (currently 17%), the proportion of revenues available for other government services and programs obviously declines. Since 1981, Newfoundland has been the only province with higher debt charges on a per capita basis, as a percentage of total revenues, and also as a percentage of total personal income.

Exhibit IV

Current Revenues and Expenditures

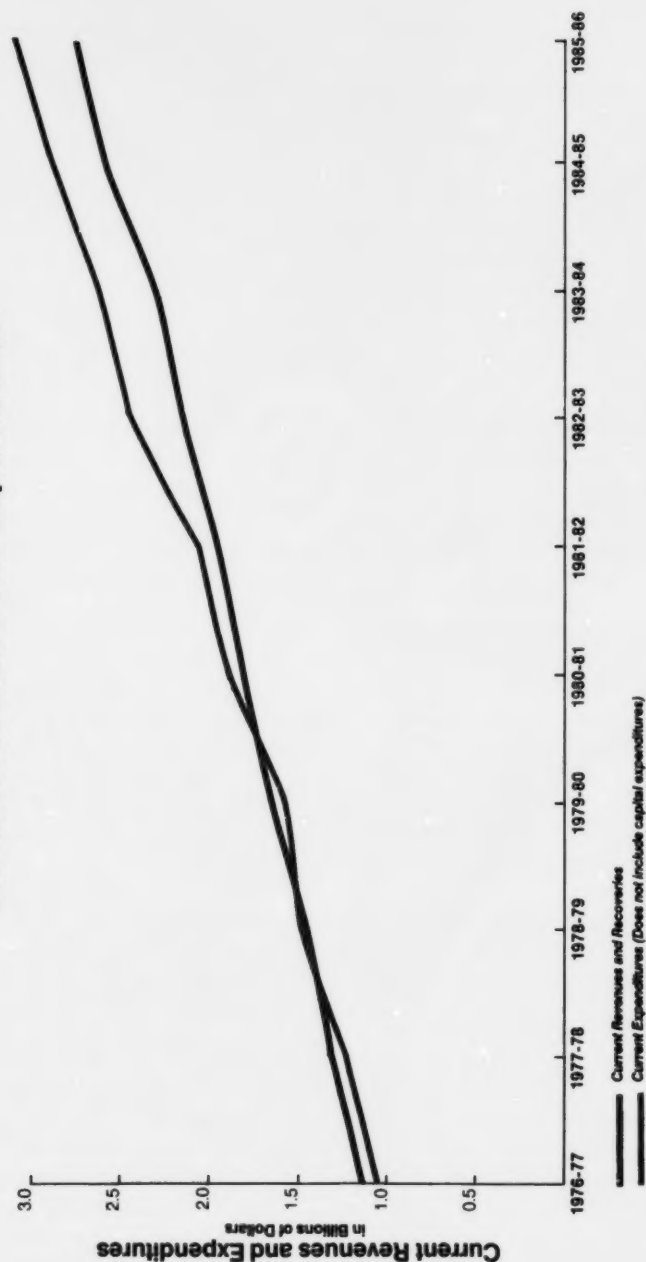
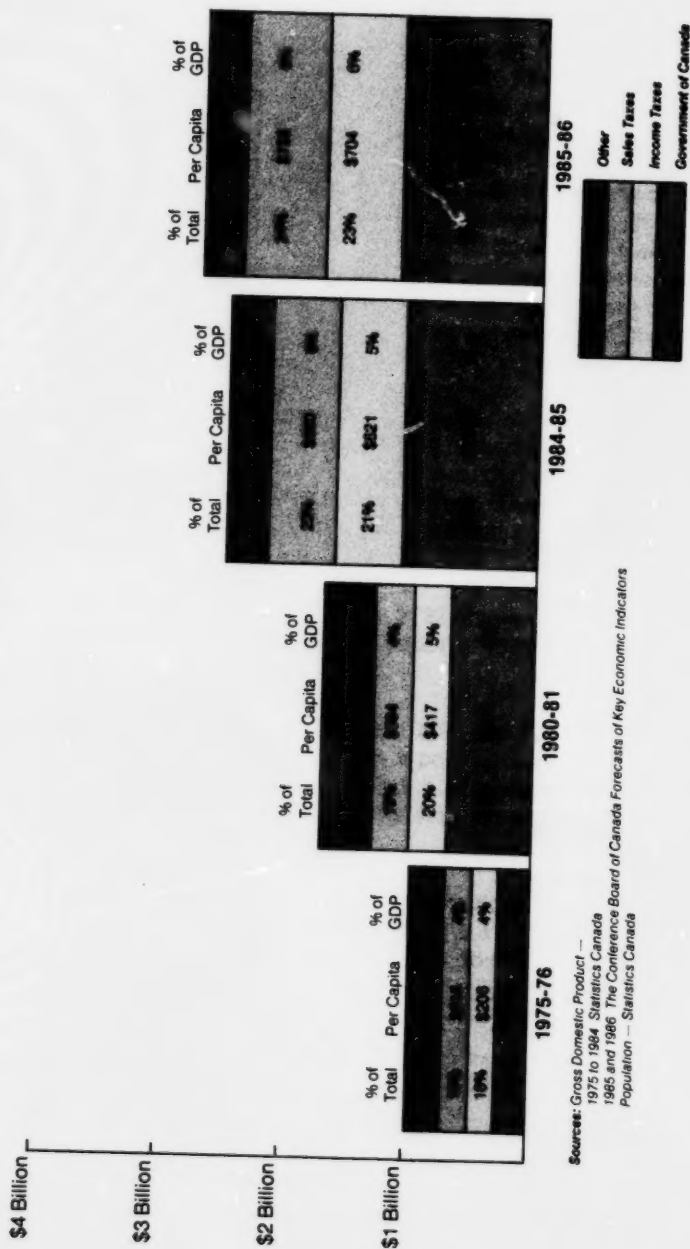


Exhibit V

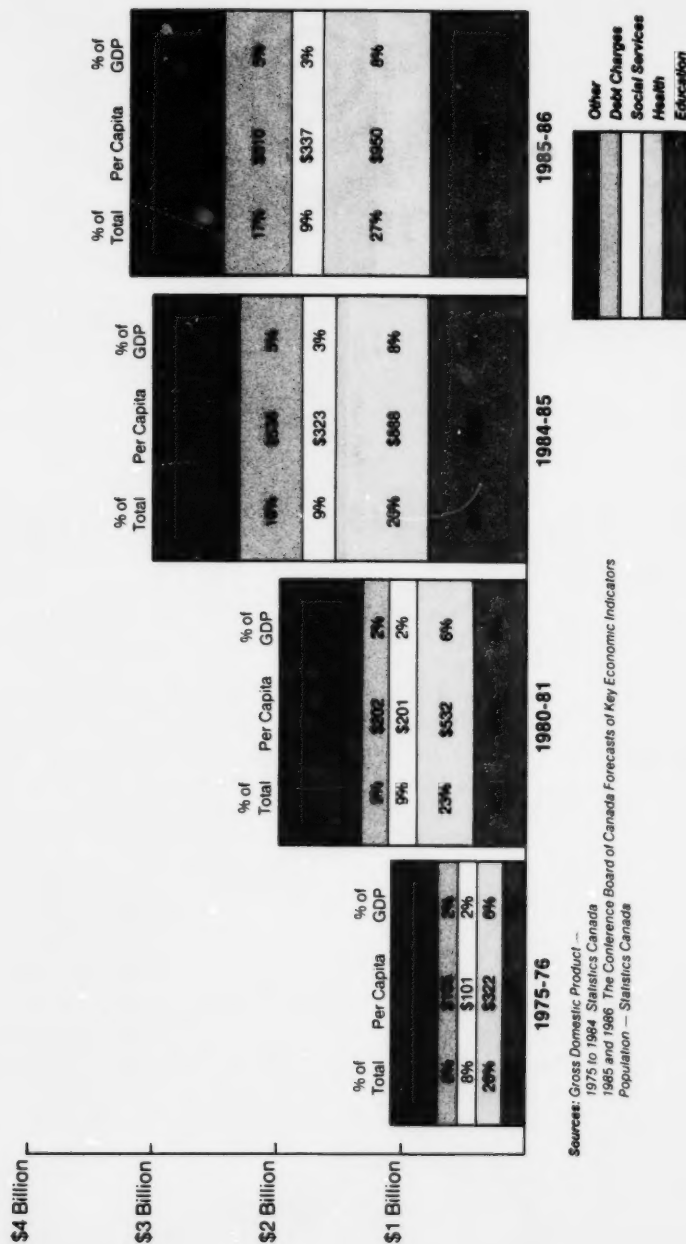
Revenues by Major Category



Sources: Gross Domestic Product —
 1975 to 1984: Statistics Canada
 1985 and 1986: The Conference Board of Canada Forecasts of Key Economic Indicators
 Population — Statistics Canada

Exhibit VI

Expenditures by Major Category



Sources: Gross Domestic Product — 1975 to 1984: Statistics Canada
 1985 and 1986: The Conference Board of Canada Forecasts of Key Economic Indicators
 Population — Statistics Canada

Exhibit VII is a comparison of the expenditures of the Province by major category for the 1984-85 fiscal year with those of the other provinces. Nova Scotia's 1985 per capita spending on education was the third highest of all the provinces. Newfoundland was the only province with higher debt service charges on a per capita basis.

Exhibit VIII compares the financial position and operating results of Nova Scotia and New Brunswick for the 1985-86 fiscal year. This comparison is appropriate for several reasons. Nova Scotia and New Brunswick are comparable in size and the two provinces experience similar economic conditions. In addition, the Public Accounts of most of the other provinces for the 1985-86 fiscal year were not available at the time this Report was written.

It is not my intention to suggest that the performance of New Brunswick should be considered as the standard against which Nova Scotia should be measured. However, there are certain relevant comparisons which readers may find of interest. These provide additional perspective to Nova Scotia's financial position and operating results.

The per capita net debt of Nova Scotia is \$722 greater than that of New Brunswick, and Nova Scotia's operating deficit for 1985-86 of \$285 per capita is \$218 higher.

Nova Scotia's expenditures (both current and capital) compare favourably with those of New Brunswick. On a per capita basis, as a percentage of gross domestic product, and as a percentage of total personal income, Nova Scotia's expenditures for the 1985-86 fiscal year were less than those of New Brunswick.

A comparison of the total revenue of the two provinces shows that Nova Scotia's per capita revenue was \$279 lower. As a percentage of total personal income and as a percentage of gross domestic product, Nova Scotia's revenue was also less.

Comparison of Actual Results to Estimates

A fourth measure of fiscal performance is the comparison of the year's actual results to the estimates for both operating revenues and expenditures. This analysis shows how well the Government has followed the fiscal plan submitted to and approved by the Legislature.

Exhibit VII a

Interprovincial Comparison of Total Expenditures by Major Category
For the year ended March 31, 1985

	Education		Health		Social Services	
	\$ Per Capita	% of GDP	\$ Per Capita	% of GDP	\$ Per Capita	% of GDP
Nova Scotia	856	7	888	8	323	3
Newfoundland	830	9	769	8	216	2
Prince Edward Island	807	9	763	8	390	4
New Brunswick	824	8	911	8	358	3
Quebec	1,077	8	Note 1		Note 1	
Ontario	603	3	922	5	288	2
Manitoba	613	4	1,006		198	1
Saskatchewan	623	4	992	6	322	2
Alberta	876	3	896	3	490	2
British Columbia	595	4	863	5	511	3
Canadian Average	770	6	890	6	344	2

Note 1: The Public Accounts of Quebec do not distinguish between Health and Social Service expenditures. The 1985 total was \$1,499 per capita or 11% of GDP. Quebec has been excluded from the Canadian average figures for Health and Social Service expenditures.

Sources: Gross Domestic Product — The Conference Board of Canada
 Forecasts of Key Economic Indicators
 Population — Statistics Canada

Exhibit VII b

Interprovincial Comparison of Total Expenditures by Major Categories
For the year ended March 31, 1985

	Debt Charges		Other	
	\$ Per Capita	% of GDP	\$ Per Capita	% of GDP
Nova Scotia	538	5	844	7
Newfoundland	566	6	892	9
Prince Edward Island	284	3	1,204	12
New Brunswick	467	4	920	8
Quebec	367	3	932	7
Ontario	323	2	786	5
Manitoba	236	2	1,128	7
Saskatchewan	100	1	1,190	7
Alberta	45	.2	1,575	6
British Columbia	94	1	960	6
Canadian Average	302	3	1,043	7

Sources: Gross Domestic Product — The Conference Board of Canada
Forecasts of Key Economic Indicators
Population — Statistics Canada

Exhibit VIII

**Comparison of Nova Scotia and New Brunswick
Financial Position and Operating Results
For the year ended March 31, 1986**

	\$ Per Capita		% of Total Personal Income		% of GDP	
	NS	NB	NS	NB	NS	NB
Net Debt	3,664	2,942	28	24	30	25
Operating Deficit (Note 1)	285	67	2	.6	2	.6
Total Revenue	3,074	3,353	23	27	25	29
Total Current Expenditures	3,359	3,420	25	28	27	29
Total Capital Expenditures	217	290	2	2	2	2

Note 1: Operating deficit is before sinking fund installments and serial retirements.
Capital expenditures are not included in these figures.

Sources: Gross Domestic Product — The Conference Board of Canada
Forecasts of Key Economic Indicators

Population — Statistics Canada

For the 1986 fiscal year, the total revenues and recoveries of \$2,715 million were 1/2 of 1% (\$14 million) below the estimated figure of \$2,729 million. Actual total expenditures for 1986 of \$2,983 million were 2.4% (\$70 million) greater than the estimate of \$2,913 million. Three areas (Resource Development at 15%, Transportation at 7% and Health at 5%) had an excess of actual expenditures over their approved Estimates greater than 4%. These three areas accounted for more than 95% of the net over-expenditure of \$70 million.

Concluding Remarks

The preceding discussion has focused upon the seriousness of the operating deficit and accumulated net debt of the Province. Although I have reported on these matters previously and a great deal has been said and written on the subject by others, I feel obliged to again emphasize certain points.

The annual deficit and accumulated net debt of the Province must be reduced. Since the early years of this decade, Nova Scotia and Newfoundland have consistently been the provinces in the weakest financial position. The effect of Nova Scotia's large net debt is spiralling. Increasing debt charges result in a larger annual deficit which leads to more borrowing. The situation is a vicious circle and the only exit is by way of reduction of the net debt through the elimination of annual deficits.

There are essentially two ways to reduce the deficit. Spending can be reduced or revenues can be increased. Revenue increases can only be achieved through higher taxes, higher charges for government services or increases in other revenues. Reduced spending can only be achieved by increasing the efficiency and effectiveness of government operations and/or reducing the level of services provided by the government. Neither approach is easy. No Government likes to be put in a position where it has to raise taxes or cut services, but the financial position of the Province is critical enough to warrant such drastic action.

There should be a viable long-range plan for reducing the deficit which can be translated into realistic annual plans. The objectives of the Government in each functional area must be carefully reviewed to determine whether they are appropriate for a province of the size and financial condition of Nova Scotia. Each government program must be

reviewed thoroughly to ensure that it is the most efficient and effective way of meeting Government's objectives. There has to be a system of rigorous control over every expenditure, both before and after actual spending takes place.

Government and taxpayers alike must recognize that, because of the Province's existing financial position, all demands cannot be met. Spending requests will have to be realistically prioritized and low priorities generally denied. If existing services are to be maintained, then higher taxes may be necessary if more economical means of providing these services cannot be achieved. Deficit reduction is no easy task, and it becomes more difficult as the deficit and net debt grow larger, so immediate and concerted action is urged.

Additional Appropriations

The Estimates tabled in the Legislature represent the Government's spending plans for the coming year. Under the Provincial Finance Act, adjustments to these spending plans, through additional appropriations, are approved by Order in Council rather than further scrutiny and approval by the Legislature. Because additional appropriations are not subject to House approval, legislative tradition places an onus on the Government to ensure that the original spending plans are as realistic as possible.

The approved 1985-86 Estimates contained 110 votes for current expenditures totalling \$2,913 million. Thirty-five of these votes required additional appropriations amounting to \$113.6 million more than originally authorized by the Estimates, the highest level since 1981-82. These were from 15 of the 21 government departments. Additional appropriations for capital expenditures were \$2.2 million. A schedule of additional appropriations for the last six years is presented below.

Additional Appropriations (\$ Million)

Year	Current	Capital	Total
1985-86	\$113.6	\$ 2.2	\$115.8
1984-85	70.6	.2	70.8
1983-84	35.1	27.7	62.8
1982-83	84.2	5.9	90.1
1981-82	166.2	24.8	191.0
1980-81	72.5	31.2	103.7

Debt charges and overexpenditures in the Departments of Development, Health, Transportation and Education accounted for 84.7% (79.9% in 1984-85) of the additional appropriations for current expenditures.

Of the 35 votes requiring additional appropriations, the original budget for three of these, Health Programs, Grants to School Boards, and Snow Removal and Ice Control appear to have been unrealistic.

Expenditures for Health Programs exceeded the Estimates by \$20.7 million. This included \$14.5 million for hospital expenditures that had not been budgeted; the additional costs were necessary to maintain services at the 1984-85 level. A similar situation was reported in our 1982 Annual Report.

In our Annual Reports for 1982, 1983 and 1984, it was noted that the Estimates for Grants to School Boards were unrealistic. The 1986 Estimates again failed to provide for increases in rates used in calculating school grants, resulting in expenditures of \$2.1 million more than the Estimates, for the period January 1 to March 31, 1986.

Snow Removal and Ice Control costs are necessarily related to the weather. While it is difficult to predict the weather, trends can aid in estimating costs for the upcoming year. A review of snow and ice removal estimates and costs for the past three years shows a decrease in budgeted expenditures, while actual expenditures have increased significantly.

Year	Estimate	Actual
1985-86	\$30,000,000	\$38,543,199
1984-85	30,000,000	35,475,596
1983-84	30,803,000	30,710,000

Again this year I draw attention to the delay in approving additional appropriations. There were 45 additional appropriations approved this year. In 33 of these cases, the Orders in Council approving the additional appropriations were dated after the overexpenditure had occurred. Furthermore, 26 of these were not requested until after year end.

The following is a listing of the additional appropriations approved after the end of the 1985-86 fiscal year. These amounted to \$75.4 million, or 65% of the total additional appropriations for the year.

Appropriations Approved after March 31, 1986

Department	Approval Date	Amount
<i>Agriculture and Marketing</i>		
Agricultural Services	July 22, 1986	\$ 2,491,355
<i>Attorney General</i>		
Registry of Joint Stock Companies	August 5, 1986	1,593
<i>Development</i>		
Industrial Development	June 3, 1986	546,200
General Administration	June 3, 1986	22,864,500
<i>Education</i>		
Finance and Budgeting	June 3, 1986	140,800
Education Resource Services	June 3, 1986	96,200
Grants and Assistance	June 3, 1986	3,969,300
Teachers' Pensions	July 29, 1986	633,800
Education Resource Services	August 12, 1986	19,200
<i>Finance</i>		
Homeowners Incentive Act Grants	April 1, 1986	2,000,000
Debt Charges	Sept. 16, 1986	20,436,700
<i>Health</i>		
Health Services and Insurance	July 22, 1986	1,478,000
Health Programs	August 12, 1986	2,272,857
<i>Lands and Forests</i>		
Operations	April 1, 1986	436,700
Other (Capital)	April 1, 1986	820,200
Administration	April 1, 1986	179,100
<i>Public Service</i>		
Nova Scotia Horse Racing		
Commission	April 1, 1986	13,000
Public Archives of Nova Scotia	April 8, 1986	50,000
Workers' Compensation Board	June 16, 1986	213,000
Royal Commission on Post-		
Secondary Education	July 22, 1986	91,700
Legislative Expenses	July 22, 1986	84,600
Protocol Office	July 22, 1986	48,600

Government House	July 22, 1986	25,200
Power Rate Assistance	August 12, 1986	1,806,366
Nova Scotia Boxing Authority	October 7, 1986	1,375

Social Services

Public Assistance	April 22, 1986	1,560,400
Family and Children's Services	April 22, 1986	243,700
Public Assistance	August 5, 1986	892,678

Tourism

Hotel Operations	April 15, 1986	139,500
Administration	April 15, 1986	40,000
Bluenose II	April 15, 1986	138,500

Transportation

Administration and Maintenance		
Transportation Systems	April 1, 1986	10,326,100
Capital Grants (Capital)	April 15, 1986	1,355,000
		<u>\$75,416,224</u>

The preceding list indicates that 14 of these additional appropriations, totalling \$30.3 million, involving six departments plus six Public Service votes, were approved beyond mid-July. This is over three months after the year end. Section 9(2) of the Provincial Finance Act requires that a sufficient balance of funds be available in each appropriation prior to the payment of public money.

The amount of appropriations approved after year end, and the long delays in approving them continue to concern me. There is clear need for improvements in either the accounting and control routines in the departments, or for a greater degree of attention to these matters by those responsible.

* * * * *

I am required under Section 8(1) (f) of the Auditor General Act to call attention in my Annual Report to every case in which "a special warrant made pursuant to the provisions of the Provincial Finance Act, authorized a payment of money".

No special warrants were issued during the 1985-86 fiscal year.

* * * * *



**CROWN AGENCIES
AND
CORPORATIONS**

Introduction

There are 17 crown agencies and corporations, excluding hospitals, the annual audits of which are performed by chartered accountants other than the Auditor General. A schedule of these is included in Appendix IV.

Under Section 16 of the Auditor General Act I am furnished annually with the audited financial statements and all reports prepared by the auditors of these agencies and corporations. In addition, the Auditor General may conduct any such additional examination and investigation of the records and operations of the agencies as he deems necessary.

A five year schedule introduced by my Office in 1985 provides for cyclical reviews of these agencies. My audits are different in scope than those performed by the private sector auditors. I do not attempt to duplicate their work regarding an audit opinion on the entity's annual financial statements. The focus of our audits is on broader issues such as the management and organization of the enterprise, and the manner in which it is meeting its legislated or otherwise determined objectives. The results of these reviews are reported to the agency, and included in my Annual Report. During 1986 two such reviews were completed, at the Nova Scotia Liquor License Board and the Sydney Steel Corporation.

Review of Auditors' Reports

We have reviewed the audited financial statements and reports submitted by the auditors of other crown agencies and corporations. We have no major observations to report as a result of that review, other than to point out that eight of the crown agencies and corporations do not have their financial statements published in the Public Accounts of the Province.

Our 1982 Annual Report contained suggestions regarding statutory requirements for crown agencies and corporations that would enhance their accountability to the House and to the people of Nova Scotia. In my 1985 Report I stated that

"the Province requires legislation that will apply to all crown agencies and corporations, and this legislation should make provision for:

- the maintaining of adequate financial records, and preparation of interim financial statements where required for management purposes;*
- the preparation of annual financial statements and the audit of those financial statements within six months following the fiscal year end;*
- all audited financial statements to be published in the Public Accounts of the Province;*
- the notes to the financial statements to outline the legislated mandate of the entity;*
- the auditor's report to mention whether the transactions examined are in accordance with legislation, regulations, the charter and by-laws of the agency or corporation; and*
- the tabling of an annual report, including financial statements in the House of Assembly.*

In addition, an attempt should be made to more adequately define what constitutes an agency or corporation of the Crown. At present there are several definitions for crown agencies and corporations. For example, the Provincial Finance Act and Auditor General Act contain somewhat different definitions. This situation has created some problems in determining the status of certain entities."

I continue to believe that the above suggestions should be acted on by the Government.

Nova Scotia Liquor License Board

Introduction

During the past year, my Office completed an examination of the licensing and inspection operations at the Nova Scotia Liquor License Board. Although a chartered accountant other than the Auditor General is the appointed auditor of the Board, I am authorized under Section 16(2) of the Auditor General Act to conduct such additional examination and investigation of the records and operations as I deem necessary. This is the first time such an examination at the Board has been undertaken by this Office.

The objectives of the assignment were to obtain up-to-date information on the organization, policies and practices of the Board; and to review its four divisions from an operational standpoint to assess how well assigned responsibilities were performed.

The Nova Scotia Liquor License Board was established under the provisions of the Liquor Control Act to, among other things, license premises for the sale of liquor for consumption at those locations, and to inspect licensed premises for compliance with the Act and regulations.

The assignment included a review of the operating policies, practices and procedures in the Board's four divisions, namely — Finance, Administration and Licensee Relations, Licensing, and Inspection. We held discussions with the Chairman and Chief Executive Officer, the Directors of the above noted divisions, and the Counsel of the Board. We examined enabling legislation, regulations and policy statements; audited financial statements and management letters from the external auditors; and various internal manuals, reports and forms.

Results of Audit

We were able to obtain the necessary information in order to provide us with a good understanding of the operations of the Board. We did not examine each division in the depth required for a definitive evaluation of the performance of all managerial and operational responsibilities.

However, on the basis of discussions with divisional directors and a review of selected material, nothing came to our attention that would lead us to the conclusion that the divisions are not being managed in a manner appropriate to the objectives and responsibilities of the Board.

We identified several findings and observations which were reported to the Board's management, and where appropriate, made recommendations for their consideration. The more significant recommendations related to annual reporting and annual budgeting.

Annual Reporting

Section 28E(1) of the Liquor Control Act requires the Board to present only its annual financial statements to the Legislature. The Government of Nova Scotia Management Manual dealing with annual reports provides standard guidelines as to the form and content for annual reports of departments, boards, agencies and commissions that are 100% funded by the Province. This Manual suggests that an entity's activities for the year be highlighted in its annual report.

In our view, increased disclosure in the annual report would assist Members of the Legislature, and other interested parties, in obtaining an understanding of the Board's operations and accomplishments for the year.

Annual Budgeting

The Board's revenues of \$6.0 million for the year ended March 31, 1986 (\$5.9 million in 1985) consist primarily of revenues from the sale of licenses, and license revenues collected by the Nova Scotia Liquor Commission on behalf of the Board. The Board's administrative expenses of \$1.9 million for the year ended March 31, 1986 (\$1.8 million in 1985) are paid out of revenues of the Board.

The Board does not prepare an annual budget of its revenues and expenses. There would appear to be no reasons to prevent the Board from developing and using such a common financial planning and control technique. In our view, financial management and control of the Board would be enhanced if an annual budgeting process were implemented.

Conclusion

We were pleased with the results of our examination. We were able to obtain an understanding of the Board's operations, and received a positive response to our suggestions and recommendations. Most importantly, based on the results of our review, we concluded that the divisions of the Board are being appropriately administered.

Sydney Steel Corporation***Introduction***

During the past year, this Office completed an examination at Sydney Steel Corporation. Although the Auditor General is not the appointed auditor of the Corporation, I am authorized under Section 16 (2) of the Auditor General Act to conduct such additional examination and investigation of the operations and records as I deem necessary. The last in-depth reviews by this Office at Sydney Steel took place during the calendar years 1974 and 1975, both of which were reported upon in Annual Reports of the Auditor General. In addition, brief articles dealing primarily with the Corporation's financial condition appeared in our Annual Reports for 1980 and 1982.

The overall objectives of the current assignment were essentially twofold. Firstly, we were endeavouring to obtain a general appreciation of the current situation of the Corporation from both a financial and operating standpoint. Secondly, we assessed the management and control over selected areas of the Corporation's activities. The objectives for these specific activities are developed further in the relevant sections of this article.

We conducted extensive interviews with senior management who had financial, marketing, and production responsibilities; analyzed various financial, marketing and production reports, which had been prepared by corporate staff, and by consultants in recent years; and met with, and examined recent reports of, the external auditors of Sydney Steel.

During the period of our review, the Corporation and the Governments of the Province of Nova Scotia and Canada were considering proposals regarding further modernization of the steel plant. These discussions and a decision related thereto had not been finalized at the time of the completion of our audit.

The nature of the difficulties facing the steel industry, not only in Nova Scotia but nationally and internationally, are complex and certainly not susceptible to easy or predictable solutions. Accordingly, I make no attempt to express a judgement as to what remedial course of action might be best under the current circumstances. This is the responsibility of government, acting upon the advice of the Board and management of the Corporation, and I trust that whatever decision is made will ultimately prove to be in the best interest of Cape Breton, and of the Province as a whole.

The more significant matters from our audit examination are presented under four headings.

- Management and Organization
- Financial Position and Operating Results
- Operations
- Overall Conclusions

Management and Organization

The purposes of our review in this area were to obtain current information concerning the Corporation's organizational structure and management responsibilities, and also to assess certain of the management information and control systems.

There would appear to be a dedicated and competent management at Sydney Steel, who have a strong commitment to overcoming the Corporation's financial and production difficulties. They possess a full awareness of the extreme seriousness of the situation, and the magnitude of the problems facing them. They are addressing these problems with concerted and consistent effort.

In addition, we observed an open and participative style of management which would appear appropriate to the current operating circumstances of the Corporation. Our review of the minutes of the Board of Directors of the Corporation indicated that the Board is kept well informed of all key aspects related to corporate activities, and participate meaningfully in consideration of these matters.

Management has developed and promulgated a number of corporate policies within the last five years, which cover 20 specific management and operating areas.

There is a marked improvement in the management control systems currently in use, compared to those in place at the time of our last detailed review in the mid 1970's. The information systems which monitor and project financial position and operating results seem to be appropriate. The two principal control systems for production monitoring, namely the standard cost system and the key indicator reporting system, provide a degree of timely reporting. These are essential for management to monitor costs and quality of production, and to provide essential support detail for bidding and pricing decisions.

An evaluation of stage 1 of the modernization program conducted by an independent consulting firm indicated that the program was successfully managed and achieved its objective.

Financial Position and Operating Results

Our principal objective was to review thoroughly the current financial position and recent operating results of the Corporation. Insofar as possible, we attempted to determine the projected impact on the financial position and operating results of the alternatives available under the business plans being considered.

The results for the most recent year, fiscal 1986, show a final loss of \$76 million, the largest ever and an increase of nearly \$16 million over the previous year. In addition the Corporation's accumulated deficit, which comprises the cumulative total of losses over the years, has risen to \$486 million. Further details on the Corporation's financial position and operating results may be found in the Public Accounts of the Province. This publication contains the audited financial statements of the Corporation, and a brief commentary on the Province's financial involvement in Note 4 to the Province's Financial Statements.

The higher loss in 1986 was due primarily to a marked decrease in domestic rail shipments. Sales to Canadian National Railways were at the lowest level in recent years. The lower level of sales in 1986 also contributed to higher total costs per ton of production. As a result, there has been a significant loss per ton because selling prices were not always sufficient to cover full costs of production.

It has long been apparent to those associated with Sydney Steel, both at the corporate and Government level, that the Corporation is not in a position to service its existing debt load, which at March 31, 1986 was in excess of \$430 million. This debt load is attributable almost exclusively to the losses of the Corporation since it was taken over by government in 1967.

Accordingly, it has been the practice of the Corporation to measure its financial results based on "Loss before depreciation, financial charges, operating grants and extraordinary items". This is referred to as the operating loss, and represents a more meaningful measure of the Corporation's results. It was \$22.8 million for the 1986 fiscal year, compared with \$6.6 million the previous year. This operating loss has fluctuated between \$5.2 million and \$30.4 million, or an average of \$14 million, over the past six years. 1987 losses are anticipated to be significantly lower than the 1986 losses.

Furthermore, it must be clearly understood that the projections of the Corporation, under the business plan for the various stages of modernization, do not include any allowance for the servicing or retirement of existing debt. This is an appropriate assumption to have made, because future operations of the steel plant cannot realistically be expected to service or retire the present corporate debt.

Due to the current financial position of Sydney Steel and its excessive debt load, it is obvious that the Corporation is fully dependent on government support for any planned capital plant improvements. Also, there will be a need for continuing operating grants from Government at least until the modernization program is completed, should the decision be made to proceed with this program.

In overview, it has long been apparent that the Corporation is in an extremely precarious financial position; so serious that continued operations of the plant have been sustained only because of substantial government financial support. Moreover, considerable additional investment, a minimum of \$250 million to \$300 million is required to revitalize the plant.

Operations

The Modernization Program

Stage 1 of the modernization program, commenced in 1981 and completed in 1985, was essentially to secure basic operations and reduce operating costs. It comprised extensive capital improvements to the blast furnace and rolling mills operations, and significant work on the open hearth operation, environmental controls, and other services. It was completed within budget, at a cost of \$96 million, shared by the Federal Government to the extent of \$77 million, and the Provincial Government \$19 million.

Stage 2, at a projected cost of \$157 million, is intended to establish Sydney Steel as a self-sufficient, viable and internationally competitive company. It involves the installation of an electric arc furnace, a ladle metallurgy station, reactivation of the continuous caster, upgrading of the rolling mills and other improvements in services. This stage is to be cost shared between the Federal and Provincial Governments to the extent of \$110 million and \$47 million respectively.

Stage 3 of the modernization program would involve the acquisition of a universal mill and related finishing facilities at a projected cost of \$130 million. The purpose of this is to further improve productivity and product quality and also allow diversification into additional steel products. This is considered necessary because rail specifications in future will be to higher quality tolerances.

As indicated previously, there is no allowance for interest and payments on present debt in the business plans relating to stages 2 and 3. However, once stages 2 and 3 are completed, the operating results are projected by the Corporation in their business plan, to generate sufficient cash to finance the capital cost of stage 3, and to eliminate the requirement for further Government grants for operations, apart from carrying charges on present debt.

From a production standpoint, the Corporation appears to have a plan for survival that is reasonably complete and integrated, in keeping with anticipated trends in steel making, and representing the only basis for continuation of the plant.

Rail specifications in future will be to closer tolerances, only attainable in hot rolled products with a modern mill. Accordingly, stage 3 of the program should be considered as a logical and integral part of the stage 2 acquisition of an electric arc furnace capability. The existing mode of production no longer seems economically sustainable from both cost and quality standpoints.

Management and both levels of Government understand that any decision to proceed with stages 2 and 3 can only be made on the basis of market projections indicating a continuing reasonable level of demand for rails from this plant.

A summary of the capital costs of the modernization program and an approximation of other outlays follows.

	Government of Canada	Province of Nova Scotia (\$million)	Total Costs
Stage 2 capital costs	\$110	\$ 47	\$157
Stage 3 capital costs	—	130	130
Total capital costs	110	177	287
Operating grants, and estimated additional financial charges to completion of modernization	—	85	85
	110	262	372
Less: Eventual recovery of stage 3 capital costs	—	130	130
	<u>\$110</u>	<u>\$132</u>	<u>\$242</u>

The above tabulation reflects the capital cost of \$130 million for stage 3 as a direct outlay of the Province. Other means of financing may be utilized, such as separate financing by the Corporation with a guarantee from the Province. Regardless of which method is used, as a minimum a Provincial guarantee would likely be required, and this amount would form part of the Province's total debt commitment.

Operating and Capital Control Systems

In our view, the capital and major repair control system introduced in 1975 is operating effectively. As already noted, an independent consultant's evaluation of stage 1 of the modernization program indicated that this project was well managed, and completed within budget.

The standard cost system is essential for obtaining information on costs for purposes of production control, bidding, and pricing of product. We were impressed with the competence of those responsible for administration of production cost standards. Procedures for development, revision, and reporting of standards and variances are satisfactory. Accordingly, we have concluded that this system is properly maintained, and appropriate to the needs of the Corporation.

Over the last few years, management has introduced a key indicator reporting system to monitor and control operations of the plant. This system reports on a regular basis, as frequently as weekly, key information regarding productivity, quality, costs, and other matters. Associated with the system is a schedule of regular meetings at various levels of management to review operating results in comparison to standards and targets.

This key indicator reporting system provides a degree of timely management review, essential to the monitoring of costs, productivity and quality. There appears to be a high degree of participation at appropriate levels of management in this process, and recognition of its usefulness.

Marketing Considerations

Our review of the marketing function provided an appreciation of the many factors impacting upon the steel industry and especially Sydney Steel. As intended, this review did not put us in a position to definitively assess market projections and strategies, this is not in our field of competency or responsibility. Nevertheless there are certain factors relating to the steel market which should be noted.

There are clear indications that demand for rails over the next decade will involve a greater proportion of intermediate strength and head hardened rails, with more stringent surface inspections of the

finished product. In view of these tighter specification requirements, it seems essential that the cost, quality and diversification capabilities to be provided under stages 2 and 3 are critical to the Corporation retaining a reasonable share of domestic and international rail markets. This point of view is shared not only by management, but by marketing consultants who have studied the situation.

To achieve their sales projections, the Corporation must consistently sell more than 50% of its production in the international market, and maintain a degree of product quality and acceptance in this market. There are about 25 rail mills competing for a share of this market. As well, there is international competition, primarily from Japan, for certain of the Canadian market.

Canadian National has accounted for close to 90% of the Corporation's sales in the domestic market over the past 10 years. No significant growth is forecast in the requirements of Canadian railroads in the immediate future, and actually their needs could decrease.

Overall Conclusions

There are certain major conclusions derived from our review which bear emphasis.

Losses — The Corporation's final losses have averaged \$60 million over the past six years, and its operating losses (before debt charges, depreciation, grants and extraordinary items) have averaged \$14 million over the same period.

This level of losses is likely to increase significantly if the Corporation's ability to meet the price and quality requirements of the market cannot be improved.

Debt — The current debt of \$430 million cannot be serviced or retired by Sydney Steel Corporation. It is a sunk cost attributable to prior years' losses, and the full cost of interest on it and retirement of it must be borne by the Province. Under present terms, this will amount to in excess of \$500 million over the next 10 years.

Clearly these levels of operating losses and outstanding debt must be stabilized and further significant increases avoided.

Modernization Program — If the plant is to continue in operation, a decision that can only be made by Government, there is a requirement for substantial investment in stages 2 and 3 of the modernization program, in order to provide a competitive rail product.

Additional capital investments of between \$250 million and \$300 million would be required for this program.

Marketing — The Corporation faces a declining domestic rail market, and also a very competitive international market to which more than 50% of its rails must be sold.

To sell in these markets the Corporation must have contemporary technology, cost and quality performance, competent marketing capability and strategy, and sound overall management.

Summary — The purpose of our audit assignment was not to express an opinion on the alternative courses of action under consideration. Rather, it was to gain a better understanding of the underlying issues, and to review certain aspects of the management of the Corporation. We have concluded, on the basis of those areas we examined, that management is competent, responsible and striving to resolve the Corporation's difficulties.

As we were completing our audit, both levels of government and corporate management were evaluating the most recent independent marketing survey, in an attempt to decide an appropriate course of action regarding completion of the modernization program. It is no easy task to arrive at a decision because of the uncertainties, particularly in the market place, and the significant economic ramifications of each alternative course of action. Moreover, the results of a decision to complete the modernization program will not be evident for several years.

By the time this Annual Report is tabled in the House of Assembly, a definitive course of action will likely have been decided upon — one I trust time will demonstrate to have been the prudent choice.

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**SPECIAL
DEPARTMENTAL REVIEWS**

Introduction

Each year, my Office performs expanded reviews in certain areas of selected departments of government. While most of these have been at our initiative, others have been at the request of the department. These reviews are also done to assess specific queries which we may have.

During the past year, six such reviews were conducted. These were:

- Attorney General — Sheriffs
- Cash Management
- Government Purchasing Agency
- Internal Audit
- Travel Expenses
- Vocational and Technical Training

In addition, we did an update to the review we performed in 1984 in the Department of Health on their process for the annual audit of the final settlements of all hospitals.

As referred to in the Introduction to this Report, there has been a significant development in the type of audits reported upon this year. This is the inclusion of two articles dealing with government-wide issues, the audits of cash management and the internal audit function. Furthermore, these audits reflect a distinct shift in emphasis in certain of our audit assignments away from the traditional financial statement audit opinion, internal control system, and compliance with legislative and regulatory provision matters. This shift is to an evaluation of issues relating to the administration and management of the function, and the government resources related to it.

The 1984 examination conducted at the Nova Scotia Liquor Commission, and the 1985 one performed at the Department of Tourism Resort Hotels are examples of this type of special audit review. In 1986 there are four of these. In addition to the government-wide studies of cash management and internal audit, were the audits of the vocational school operation and the Nova Scotia Liquor License Board.

There is a further comment regarding these audits which gives me a good deal of satisfaction to express. It is that in all cases we were able to provide the departments or agencies concerned with what I consider to be worthwhile observations and recommendations for improvements.

Not only were these observations and recommendations well received, but many were acted upon before the audits were actually completed. To have our Office in a position not only to evaluate performance, but to provide useful suggestions for improvement, is a positive dimension of our work which I believe should be pointed out.

Department of Attorney General County Sheriffs' Operations

Introduction

The Department of Attorney General maintains public offices throughout the Province for Registry of Deeds, Probates, Prothonotaries, Sheriffs and Provincial Judges. These offices have been subject to periodic audits by my Office.

Prior to 1985, our practice had been to visit two or more locations annually, and perform reviews of all public officials in these locations. However, this did not permit us to obtain an overall perspective on the total operation throughout the Province by type of official, and the relationship of each office with the Department's head office in Halifax.

To provide this perspective, we revised our approach in the 1984-85 year. In one assignment, we now audit the public officials of the same type at all or most locations throughout the Province. In conjunction with this, we examine related activities in the Department's head office in Halifax.

The first of these expanded assignments was a review of the Provincial Judges Administration Units reported in my 1985 Report. A second one, completed this year, was on County Sheriffs' operations.

The objectives were to determine whether there were adequate systems of control over revenues, expenditures, and trust account operations; and whether staff performance in these and related areas was in compliance with government and Department policies and regulations.

Our audit encompassed 13 of the 18 sheriffs' offices in the Province, and related work at the Attorney General's head office in Halifax. On the basis of this review, we concluded that the accounting systems were

satisfactory, with no serious deficiencies evident. There were no significant compliance deviations from government policies and regulations, except as briefly described in the following paragraphs.

System Deficiencies

There were three deficiencies in the operating systems, which are essentially common to all sheriffs' offices, as tabulated below.

- There is an inadequate segregation of duties in most County Sheriff Offices due primarily to limited staff availability. Because of this weakness, a greater degree of monitoring is necessary from head office. Our recommendation is that an internal audit position be established at head office to perform this function.
- As part of their duties, Sheriffs are required to serve court orders for the payment or recovery of money in a proceeding (termed writs of execution). Section 21 of Part I of the Costs and Fees Act requires travel costs to be charged at approved government rates when these writs are served. However, this section of the Act cannot easily be applied in situations when more than one writ is served. In our view, Section 21 of the Fees Act should be amended to provide a flat rate for travel costs when serving execution orders.
- The use of results indicators was not well developed for County Sheriffs' Operations. In particular, efficiency and level of service indicators were lacking.

Non-compliance with Department Policies and Procedures

Our review of compliance with Department policies and procedures at the County Sheriffs' Offices revealed cases where these were not being followed, such as:

- money received is often not recorded on official receipt forms as soon as possible;
- there is often a failure to reconcile pre-numbered cash receipt forms to daily deposit slips;
- bank deposits are not made on a timely basis;
- in some offices, two signing authorities are not required on trust cheques, and in one office, cheques had been signed in advance;

- in some offices, steps taken in collecting monies owed on execution orders were not always recorded on a standard form, and the completeness and accuracy of the information recorded varied greatly among offices;
- in one case, bank reconciliations could not be produced for six months of the year;
- deficiencies in the physical security over petty cash were noted in several offices; and
- in some cases, quarterly reports were not submitted with required supporting information, and we were unable to determine if all quarterly reports to the Department's head office were properly approved by the sheriff.

In addition to the above, there were other minor instances of control deficiencies, non-compliance with prescribed policies, and other clerical oversights at each of the 13 offices we visited, which have been pointed out to Department staff.

Concluding Remarks

The foregoing tabulation of deficiencies is more detailed than in previous years' Annual Reports relating to the Department's public officials. This is because the audit performed in the sheriffs' offices was more in-depth and covered more offices than had been the case in prior years.

There are some systems weaknesses and compliance deviations which warrant attention by the Department, but these are not serious. One is the control deficiency due to inadequate segregation of duties which, as acknowledged, results from limited number of staff in the various offices. It is not suggested that staffing be increased, but a greater degree of independent check should be carried out by head office. This, in our view, is an appropriate role for an internal audit function.

Two matters relating to cash receipt and disbursement procedures bear repetition. There must be strict adherence to the requirement for two signatures on cheques, and none signed in advance. Cash receipts should be deposited promptly in accordance with Department requirements.

Cash Management Study

Introduction

The following quotation from *Modern Cash Management*, CCH Canadian Limited, 1986 provides a succinct focus on this topic.

"Cash management can reduce borrowing costs, improve customer, supplier and banking relationships, provide vital management information, firm up a credit rating, enhance operational efficiency and position of an organization for growth and expansion. Best of all, cash management can be a highly profitable venture for the user."

The need for comprehensive cash management policies and practices should be apparent from an analysis of the 1986-87 Estimates for the Province of Nova Scotia. The combined current and capital expenditures of the Province are budgeted to exceed \$3.4 billion, while revenues and recoveries (current and capital) will exceed \$2.9 billion. There are other items to be considered, such as sinking fund installments and serial retirements (\$87.2 million budgeted in 1986-87), and capital construction programs for hospitals and schools, which require the Province to disburse funds on behalf of others.

Obviously then, the effective management of the inflows and outflows of cash can produce financial benefits for the Province. Likewise, anything less than an appropriate degree of cash management will result in additional and unnecessary costs.

Accordingly, my Office has completed a review of selected areas related to the cash management function within certain departments of Government. This assignment represents our initial effort at examining this subject on a government-wide basis.

During the assignment, specific situations were noted where there are potential financial benefits to the Province if alternative or improved cash management practices were used. In total, based on the information available and our assumptions, which included a 10% cost of capital, the potential financial benefits identified were estimated to be at least \$1 million per year. However, it must be noted that the realization of these benefits may require additional costs in certain situations.

To the best of our knowledge, the conditions which gave rise to the potential savings, and other matters identified have existed for a number of years. Accordingly, our report to Government on the subject of cash management, which details the areas of potential savings and suggested improvements for consideration, is intended primarily as a vehicle to assist in the implementation of corrective action, in order to achieve better overall cash management.

Approach

For our purposes, cash management was defined to include those functions and activities which relate to the management and co-ordination of cash flow, as well as planning for the Province's cash requirements or availabilities.

The assignment involved determining the roles and responsibilities of departments as well as the policies and practices in place relating to cash management. The existing cash management practices were compared to generally accepted practices and other criteria obtained from a number of sources. We referred to recent publications dealing with cash management. The legislative audit offices in seven provinces were contacted to gather information on cash management practices. Two large Nova Scotia based companies were also contacted. Our purpose was to confirm whether the contemporary cash management practices which we considered appropriate were being used by others.

The assignment included the random selection and testing of a sample of disbursement and receipt transactions recorded during the 1985-86 fiscal year. The purpose of this testing was to assess the timeliness of disbursements and deposits of receipts, in order to identify improvements which would result in financial benefits.

All aspects of cash management in the Province were not reviewed. Crown corporations and agencies were excluded, and not all departments were covered. Those departments included were not necessarily subject to a complete and thorough review of all areas relating to cash management. The trust and semi-trust function at the Department of Finance, the long-term borrowing process of the Province, and foreign currency transactions were not included.

The assignment was conducted to provide coverage of the cash management activities in three areas.

- Management and forecasting of cash flow
- Banking arrangements
- Payment of accounts

Management and Forecasting of Cash Flow

The management and forecasting of cash flow can be a critical factor in determining the financial success or failure of an organization. Due to the amount of money flowing through the Consolidated Fund of the Province, proper planning and control of cash flow can lead to significant savings and benefits.

Based on our research, we expected that an organization the size of the Province would be using contemporary, state of the art cash management practices. These would be based upon sound management practices and include:

- formal written policies for cash management and assignment of responsibilities for the day to day management of the function;
- knowledgeable staff capable of applying contemporary practices in this area;
- procedures to provide for the maximization of interest income from excess cash and invested funds, and the minimization of interest expense on borrowed funds;
- short-term cash forecasting for a suitable period;
- integration of the results of short-term forecasting with the Province's budget process, and a longer term cash forecasting process; and
- a timely cash management information reporting system, and procedures to monitor and evaluate performance of this function.

General administrative concerns

Lack of written formal policies and guidelines — Formal operating policies and guidelines relating to cash management have not been prepared for those responsible for cash management in the departments. There was a limited awareness of or priority given to cash management in certain of the departments which we contacted. Some of the specific potential benefits identified can be attributed to this situation.

Lack of interdepartmental communication — There is limited and inadequate communication between Finance and the other departments with respect to cash flows. The formal exchange of information is required not only to increase the level of awareness in the departments, but to provide Finance with the information required to forecast cash requirements and availabilities. Cash management information is already available in some departments, but is not being provided to Finance.

Staffing — Responsibilities for specific cash management activities within Finance are not clearly assigned. Management and staff involved in the day to day cash management activities have other important financial and accounting responsibilities and cannot always devote sufficient time to cash management.

Finance has plans to reorganize the Trust and Debt Management Division. This will include the addition of at least one position and the realignment of responsibilities to provide more resources to the cash management function.

Performance and accountability — Because of the lack of formal policies and guidelines, it is not possible to measure performance against predetermined standards. For example, there should be requirements that recovery claims be filed promptly after costs are incurred, cash be deposited the same day it is received, receivable balances be effectively monitored and collected, and the disbursement function ensure that invoices are not paid prior to their due date unless a cash discount is offered.

There is little motivation for departmental management to initiate the actions necessary to improve the cash management activities. Management and staff of the various departments are not held accountable for those situations where their decisions and activities have resulted in less than effective cash management practices.

Cash requirements projections

The preparation and maintenance of detailed cash projections or forecasts is the norm for other large organizations, yet the Province does little in this area. In our view, the lack of detailed cash forecasting has led to the loss of interest revenue on idle cash balances, and the incurrence of more costly overdrafts, rather than planned short-term borrowing on the money market.

Daily bank balance projections — Department of Finance staff prepare daily projections of bank balances. Because they are sometimes not completed in time for Finance to arrange suitable short-term investments or borrowings, these are often of limited value. In such situations, the Province usually pays higher rates on borrowed funds through the use of bank overdrafts, or receives lower rates when excess funds are left in bank accounts.

The Province has two basic methods of short-term financing. The banks provide overdraft loans at the prime rate, or short-term loans are arranged on the money market at a rate which is usually lower than the prime rate.

We have estimated that during the 1985-86 fiscal year, if the Province had been able to make more use of the money market instead of bank overdrafts, the interest saving would have been in the vicinity of \$108,000.

Also, the Province could have earned an estimated additional \$10,000 per year if excess funds in the Bank of Nova Scotia general account were invested on the money market. We estimate that if the cash balances in the Teachers' Pension Fund and Public Service Superannuation Fund bank accounts during the 1985-86 fiscal year had been invested on a short-term basis, the Funds could have earned an additional \$75,000 per year in interest.

Short-term cash forecasts — Much of the Province's cash flow is reasonably predictable as to amount and timing. Finance's short-term cash forecasting procedures are too informal, not in sufficient detail, and do not make full use of information on future expected cash flow which is available within the Department and from other departments.

The other entities which we contacted considered detailed short-term cash forecasting an integral component of their cash management function.

Long-term cash forecasts — Finance does not develop a forecast of the longer term cash flow of the Province. Such a forecast would integrate cash requirements from the budgeting process and provide information to support the Province's debt management and planning process for the next two to five years.

Other entities contacted prepare multiple year cash forecasts which are closely linked to their budgeting process.

Claims for cost recoveries

Claims for cost recoveries under the Canada Assistance Plan are filed by the Department of Social Services. At present, there are delays in the filing of these claims.

Monthly claims for welfare services are currently filed approximately six weeks after the end of the month during which the costs were incurred. If these claims were filed one month earlier, the Province could save an estimated \$300,000 per year.

Final claims for the fiscal year are currently filed five months or more after the year end. If these claims could be filed two months after the year end, the potential benefit to the Province is an estimated \$35,000 per year.

Delays were also encountered in filing Canada Assistance Plan claims for recoverable data processing costs. If the final data processing claim for the fiscal year could be filed two months after the year end, the estimated benefit to the Province would be approximately \$23,000.

The Department of Social Services' data processing costs could be claimed under the Canada Assistance Plan each month. At October 1986, no data processing costs had been claimed by Social Services for the 1986-87 fiscal year, although its budget for data processing is \$1.8 million and 50% of this is recoverable under the Canada Assistance Plan. These delays could have been avoided by adequate and timely communication between the Departments of Social Services and Government Services.

Hospital construction

The majority of hospitals constructed in the Province are financed on the basis of a 40% grant from the Province, 40% borrowed from the banks in the name of the hospital, and 20% recovered from the hospital or community.

During the construction period, the banks provide a bridge financing line-of-credit to temporarily finance the 40% which will ultimately be financed by a long-term loan in the name of the hospital. The bridge financing rate is approximately 1/2% below the Province's cost of short-term capital.

The Department of Government Services pays invoices from vendors and contractors during the construction period, and then bills the Department of Health to begin the process of recovering the community share and utilizing the bridge financing. There have been significant delays in preparing and issuing billings by Government Services. As a result, the community share has not been recovered as quickly as possible and the Province has used its own short-term capital instead of the bridge financing loans during this period. The hospital or community is billed for interest only if it is incurred on the bridge financing line-of-credit.

Therefore, 20% of the interest incurred during the delay period has been borne by the Province instead of the community. The Province is planning to embark on a number of major hospital construction projects, and could save an estimated \$210,000 over the next five years if the community share is billed and recovered on a more timely basis.

This delay has also resulted in the incurrence of interest during the delay period at a rate which is 1/2% higher than necessary. The Province could save an estimated \$87,000 over the next five years by using the lower rate bridge financing as early as possible.

Timeliness of deposits

Effective cash management requires that cash receipts be deposited as quickly as possible. Tests performed on the cash receipts of the Province indicated that the average length of time from the date cash is received to the date of bank deposit is 1.5 working days with a range from same day deposit to deposit 12 days after cash is received. The goal of the Province should be to have all incoming cash deposited to interest-bearing accounts on the day that it is received.

The audit of the Provincial Tax Commission showed that incoming health services tax cash receipts are subject to a minimum one day delay before deposit. Discussions with staff of the Ministry of Revenue of Ontario and two large Nova Scotia companies indicated that a one day delay in making deposits is not standard practice. If these cash receipts could be deposited on the day they are received, the estimated annual saving to the Province would be in the range of \$120,000-\$150,000.

Subsequent to the completion of this assignment, the Provincial Tax Commissioner indicated that changes will be made to procedures to facilitate the same day deposit of health services tax receipts.

A similar situation exists at the Registry of Motor Vehicles. Elimination of a one day delay in depositing Motor Vehicle cash receipts could save the Province an estimated \$10,000 per year. The Registry plans to address this issue as part of the implementation of a new licenses and registration system.

Interest on unpaid taxes and appeals

The Health Services Tax Division of the Provincial Tax Commission currently does not charge interest on overdue accounts receivable and assessments which are under appeal. Health Services Tax Division staff have estimated that interest revenue of \$700,000 could be generated in the first year of charging interest on overdue accounts.

The latest amendments to the Health Services Tax Act Regulations include a provision for charging interest on overdue accounts receivable. The Provincial Tax Commission intends to begin charging interest on overdue taxes and appeals as soon as possible.

Summary and conclusions — As a result of our review of the Province's procedures for the management and forecasting of cash flow, we believe that in certain key areas the procedures are inadequate for an organization of the financial size and complexity of the Province.

The more significant inadequacies we encountered are summarized in the following paragraphs.

- The practices in effect are not based on formal written policies or contemporary cash management techniques. The informality has led to a certain amount of confusion in the departments, and also to actions which may not be optimal ones. The delays in filing claims for cost recoveries can be partially attributed to this situation.
- The preparation and maintenance of detailed cash projections or forecasts is the norm for other large organizations, yet the Province does little in this area.
- The lack of detailed and timely cash forecasting is contributing to the loss of interest on excess bank balances, and the incurrence of costly bank overdrafts rather than planned short-term borrowings.
- Delays in the issue of billings by Government Services and the lack of co-ordination between the Departments of Health and Government Services is leading to the incurrence by the Province of unnecessarily high interest costs to finance hospital construction.
- Cash received by the Province (except for Federal transfer payments) is generally deposited in the bank on the day following its receipt, or later. The importance of making deposits on the day that the cash is received must be stressed. Banking arrangements must be reviewed to ensure that the Province is earning interest on deposits as soon as possible.

Banking Arrangements

The Province of Nova Scotia deals with five major chartered banks and has approximately 150 separate bank accounts at various branches throughout the Province. There is at least one general account with each of these banks through which most of the Consolidated Fund cash flows.

The Finance Act provides general guidelines for the establishment and control of bank accounts. However, the specific policies and procedures to be followed have not been formally documented and approved. Instead, like a number of other activities relating to cash management in the Province, they have evolved over the years.

Administration of banking arrangements — The Department of Finance does not obtain written tenders for the provision of banking services. The banking arrangements were negotiated individually as required and have been in place for a number of years.

There are significant differences in services available and costs among the major banks. Finance does not formally review and assess the Province's banking arrangements and costs on a regular basis. Formal review and tendering for banking services at regular intervals could result in lower total costs to the Province.

Most of the Province's bank accounts are "cash-in-transit" accounts, for deposit only. As noted, the Province maintains general accounts at each of the five major banks dealt with, which are used for high volume and larger transactions as well as to consolidate balances transferred from other accounts.

The banks have different procedures and costs for dealing with transactions and the interest due to or from the Province. There was a degree of confusion or uncertainty noted with respect to the specific banking arrangement terms and conditions which were in effect at the time of our audit assignment.

The practice of dealing with five major banks may be expensive due to the differences in services and costs as well as the additional administrative and control procedures required.

Cost of banking arrangements — The Department of Finance does not prepare, on a regular basis, a summary of the costs of its banking arrangements. A summary analysis of the total costs of the existing banking arrangements would seem essential for making decisions relating to banking services and costs.

Electronic funds transfer — To date there has been limited use of electronic funds transfer for regular recurring transactions. The decision regarding the use of electronic funds transfer should be made for each type of transaction or request based on established policies and guidelines. Electronic funds transfer should be used in those situations where there is a financial benefit to the Province.

Summary and conclusions — As a result of our review of the Province's banking arrangements, we concluded that a number of improvements are required in this area.

- The administration of the banking arrangements should include regular formal reviews of the current arrangements and comparison with existing alternatives. We believe that the Province could obtain benefits in terms of lower costs and better service if the procedures for reviewing and assessing banking arrangements were formalized.
- There are various alternatives to the administration and control of banking arrangements (such as tendering for banking services, signed banking agreements and dealing with fewer banks) which should be investigated by the Department of Finance. Decisions regarding the banking arrangements should be based upon formal and thorough cost-benefit analyses.
- The use of electronic funds transfer should be investigated and evaluated to see where it would result in cost savings.

Payment of Accounts

The payment of accounts function is performed by the Department of Finance for all departments except Transportation which operates its own. Both payment of accounts functions make extensive use of computerized systems to issue and account for cheques generated.

Early payments — Invoices for payment at the Department of Finance are processed and paid on a first in, first out basis with no specific regard given to the actual payment due date.

Unless there is a discount offered for early payment which provides a financial benefit, the payment of suppliers' invoices prior to their due dates results in additional costs to the Province. These costs can take the form of interest on additional short-term borrowings or lost interest on reduced short-term investments.

While both Finance and Transportation are now attempting to take advantage of discounts offered by suppliers where there is a benefit to the Province, to date there has been little concern about the possibility of early payments. The due date feature of Finance's computerized payment system is not utilized, while Transportation infrequently uses the due date feature of their system.

Our testing of payment transactions at Finance indicated that 65% of the total dollar value of the invoices sampled were paid an average of nine days prior to the due date. While it may not be possible to eliminate all situations where invoices are paid prior to their due dates, there are potential savings if Finance can minimize the number and amount of early payments. Assuming a cost of capital of 10%, we estimate that the financial benefit could be approximately \$160,000 per year.

Payments by the Department of Transportation are also made prior to the invoice due date. Based on information from management and assuming a cost of capital of 10%, we estimate that the financial benefit could be approximately \$109,000 per year, if invoices are not paid prior to their due date unless a cash discount is offered.

Summary and conclusions — As a result of our review of the Province's payment of account function, we concluded that significant numbers of invoices are paid prior to their due dates. These early payments are costly to the Province and could be reduced if the due date features of the accounts payable systems were utilized.

Concluding Remarks

The existing cash management practices are inadequate for an organization of the financial size and complexity of the Province of Nova Scotia. Other provinces and organizations use more contemporary methods to manage their banking and cash flow activities.

We perceived a general lack of awareness of the financial impact that good cash management can have. Accordingly, the degree of priority afforded this function has been insufficient. There is a requirement for the development and communication of policies and

guidelines with respect to the cash management function and related activities. Better communication and coordination between the departments and the Department of Finance regarding the day to day management of the Province's cash flow and requirements is also needed.

During this assignment, we noted specific situations where the Province could achieve financial benefits if improvements were made to cash management practices. In total, we estimate that these potential benefits or savings could be in excess of \$1 million per year. The incurrence of certain costs may be necessary to achieve these savings. There may also be certain other factors which should be considered before the Province decides on each savings opportunity.

It would seem imperative that contemporary techniques of cash management be implemented, in order to maximize savings to the Province. These would include the following.

- All cash received should be deposited the same day to the credit of the Province.
- Interest should be charged on overdue accounts receivable.
- Invoice payments should not be made prior to their due dates, unless there is an adequate cash discount offered.
- Claims for costs to be recovered from entities outside the Province should be filed as quickly as possible.
- The costs of short-term financing should be minimized by resorting to lower cost bridge financing whenever possible, and by obtaining payment sooner from those for whom major construction is undertaken by the Province.
- Detailed and timely short-term cash forecasting should be in place to project cash requirements or availabilities, and to minimize overdraft and idle bank balance situations.
- Short-term cash forecasting should be tied into the Province's budget process and longer term cash flow planning.
- Efforts must be made to obtain banking services at the lowest possible costs commensurate with the services required.

Government Purchasing Agency

Introduction

In 1979, in response to matters raised in previous Auditor General Annual Reports, a management consulting firm was engaged to perform a management review of the Nova Scotia Government Purchasing Agency. Their report identified various weaknesses in operations, and provided a series of findings and recommendations in two areas — legislation and operating practices.

During 1985, we performed the first phase of a review of certain aspects of the operation of the Purchasing Agency. The specific objectives of this phase were to determine the extent to which recommendations made by the consultants in 1979 had been acted upon, and to plan a second phase of detailed testing of purchasing activities and transactions.

Our report on phase one was sent to the Purchasing Agency in April 1986. A summary of these findings and recommendations was included in the 1985 Auditor General Annual Report.

It was our overall conclusion that the Purchasing Agency was a reasonably effective organization, and existing practices appeared to be in compliance with the Government Purchases Act.

The second phase of our review was conducted in 1986, and a report issued to the Agency in February 1987. The objectives of the second phase were to assess the systems and procedures relating to the acquisition of goods and services at fair and reasonable prices, and to review the practices relating to "area buying" and "buy Nova Scotia" policies of the Government. In addition, we reviewed various administrative matters.

In overview, based on our examination, we can reiterate the conclusion derived at the completion of phase one. The Government Purchasing Agency is functioning reasonably well and fulfilling its responsibilities in an effective manner. The following paragraphs summarize the principal findings and recommendations from the detailed report.

Fair and Reasonable Prices

Perhaps the most effective way of ensuring fair and reasonable prices is to obtain competitive bids from approved suppliers. The Government Purchases Act requires that three tenders be received for all purchases in excess of \$1,000, and further that any deviations from this requirement be reported monthly to the Auditor General.

The audit tests we performed indicated that the Purchasing Agency was inviting tenders and following the provisions of the Act.

In our review of the tendering procedures, we determined that in 82% of the cases, and 51% of the value of purchase orders, three tenders were invited. Where three bids were not received, more than three quarters of these were cases in which there was only one known or approved source. This situation was primarily for purchases for the Victoria General Hospital and the Central Drug Purchasing Program administered by the Nova Scotia Hospital.

To determine whether the Agency was obtaining fair and reasonable prices, we selected a sample of purchases for purposes of comparing to competitive prices. We were unable to pursue further some of the sample items because the specifications were such that a comparative bid could not be obtained, or the low bid did not meet specification requirements.

In 70% of the purchases examined, the Purchasing Agency obtained prices the same or lower than competitive bids. A higher price was paid for 17% of the items examined, because of area buying or buy Nova Scotia policies. Lower prices were available in 7% of the sample, if the Agency had opted to buy through the Federal Government's Supply and Services Canada catalogue. However, there were instances of purchases made by the Agency at prices less than those quoted in the catalogue. The remaining 6% of our sample comprised purchases of an emergency nature, or for which the Agency confirmed a purchase, the responsibility for which had been delegated to a department. Of these, one-third was acquired at higher than comparative prices.

The Agency's ability to obtain the lowest price is influenced by the Government's area buying and buy Nova Scotia policies. If one considers only those purchases which are controlled by the Agency, goods were purchased at fair and reasonable prices. However, there

may be instances where the Agency could acquire goods through Supply and Services Canada at a lower price, or at least utilize the catalogue for price comparisons with submitted bids.

Area Buying/Buy Nova Scotia

Area buying is a practice sanctioned by Section 8(c) of the Government Purchases Act which reads "... so as to provide a reasonable distribution of Government business in the Province, but consistent with good business practices, in respect of certain purchases, the Agency may deal with bona fide dealers and suppliers in a certain area of the Province but always at competitive prices prevailing in the said area, or at fair and reasonable prices."

Buy Nova Scotia practices are provided for under Section 8 (b) which reads "... insofar as it may be consistent with good business practices and in the public interest, shall purchase Nova Scotia products and purchase from persons who maintain and operate places of business in the Province of Nova Scotia."

These initiatives were given further impetus in 1984 by the publication of the Government's White Paper on: Economic Development, "Building Competitiveness", which stated that "in support of ongoing economic development in the Province, The Government of Nova Scotia will optimize Nova Scotian content in that [their] purchasing."

In response to a recommendation of our phase one review, the Agency prepared an operating routine containing general guidelines for implementing and controlling area buying. We acknowledge that it may not be possible to formalize precise percentage and dollar guidelines for administration of the area buying and buy Nova Scotia policies. Nevertheless, my Office will continue to periodically review the reasonableness of the additional costs incurred in supporting these two policies.

In a sample test of 16 instances where area buying policies influenced the awarding of a purchase order, we found that the additional cost was 4.2%.

In our review of a selected number of items purchased under the buy Nova Scotia policy, there was an excess cost of 13.5% or \$124,000. It should be pointed out that virtually all of this relates to purchases from Nova Scotia manufacturers, for which there is extensive local labour and material content, and the majority of this excess has received Executive Council approval. There were four instances where excess costs were 10% greater than the lower bids. Of the buy Nova Scotia purchases reviewed, there were 13 instances where comparative bids were not obtained. Accordingly, from the information available to us, we could not determine whether a competitive or a fair and reasonable price was paid.

Our audit tests do not indicate that an excessive price was paid for the area buying and buy Nova Scotia policy initiatives. However, it is imperative that the costs for these programs be monitored to ensure that unduly high prices are not paid in any specific instance.

Other Purchasing Matters

We reviewed the process used by the Agency to place potential suppliers on the approved bidders' list. In only one case did we find that a request to be put on the list was not acted upon. In this instance, a Nova Scotia manufacturer may not have had an equal opportunity to compete in supplying goods. We have been advised that subsequent to our audit finding being made known to the Agency, this particular supplier has been placed on the bidders' list, and included in tender requests.

We reviewed the procedures used to select suppliers under the Central Drug Purchasing Program administered through the Nova Scotia Hospital. We are not in a position to assess the committee's selection decisions regarding vendors for most drug items. Our conclusions regarding the structure for administration of this program and the purchasing process followed subsequent to committee decisions are that both appear to be appropriate.

We made recommendations on certain administrative matters such as a vendor rating system, contract listings and the computerization of information systems.

Conclusions

As a result of our audit tests, I conclude that the systems and practices in place are adequate to ensure goods and services are acquired at fair and reasonable prices. In those instances where area buying and buy Nova Scotia policies influence the awarding of purchases, the additional costs are not unreasonable. Prudent application of these two policies must ensure that unduly high prices are not paid in support of these initiatives.

Department of Health

Review of Final Settlement Process

In my 1984 Annual Report I indicated that, at the request of the Deputy Minister, we had reviewed the process utilized by the Department of Health's Finance Division in their performance of annual final settlement audits of hospitals' expenditures. We issued a report on this assignment which included four principal recommendations with supporting direction relating to the planning, execution and administration of these audits.

In August 1986, we undertook a follow up to assess the progress in implementing the recommendations from our audit. Based on the results of this review, it was evident that the Department had implemented many of our recommendations and made significant improvements in its final settlement audit process.

We concluded that a more effective planning approach has been introduced, more appropriate audit documentation is now being prepared, and a greater effort is being made to improve the timeliness of audit completion. There is a more efficient use of the Department's audit resources, and the accounting counsellor group is now able to conduct more meaningful work in such areas as budgeting, cost analysis and related hospital accounting and financial areas.

Government-Wide Review of the Internal Audit Function

Introduction

Currently there are internal audit groups in two departments, and individual internal auditors in four others. In 1978 this Office examined the internal audit function in three departments of government, plus two crown agencies or corporations. Since then there has been marked improvement in the practice of the function, but due to our awareness of certain shortcomings in roles, performance and effectiveness, we decided to perform an in-depth audit encompassing all departments of government.

Internal audit is best described by reference to the Institute of Internal Auditors' statement of responsibilities. *"Internal auditing is an independent appraisal activity established within an organization as a service to the organization. It is a control which functions by examining and evaluating the adequacy and effectiveness of other controls."*

The operations of the Government of Nova Scotia are extremely complex as well as costing over \$3 billion. Accordingly, there is a need for internal audit as an integral part of the management process.

Recently other governments in Canada have acknowledged and strengthened the role of internal audit within their jurisdictions. In the past, this Office has stated the need for improvements and expansion of internal audit. We believe that it has often been under-utilized, perhaps due to a lack of understanding of its role and benefits.

In our original planning of this assignment, we were aware that only six departments had what might be considered fully operative internal audit, and that others had various inspection and review capabilities which we termed to be quasi-audit in nature. We knew, however, that at least half of the departments, some relatively large and complex, had no formal audit or review function.

With this understanding, our primary objective was to evaluate internal audit, where it existed, against a set of acknowledged criteria, and to determine the degree of need for it in the other departments.

The criteria we used were based on those established by professional auditing groups in North America. These criteria describe the need for the proper positioning of the group within the entity; a written mandate and authority to review all aspects of the organization's activities; and staffed by competent professionals, who maintain technical competence through continuing education. Criteria related to proper audit planning, performance of audit work, and the reporting process were also employed.

We evaluated those departments with some internal audit or review function to assess how well they were performing this work. Those departments not having an internal audit or review function were reviewed to determine the need for such activity.

Need for Full Time Internal Audit

We identified four departments where at present there is no significant internal audit or review function. The four are the departments of Attorney General, Education, Government Services, and Vocational and Technical Training.

These departments have significant expenditures, diversity of operations, high profiles within the Government as well as within the Province, and in many instances have decentralized operations.

The table set out below provides an indication of the size of each of these departments.

1986-87 Estimates

Department	Funded Staff	Current Expenditures	Capital Expenditures
Attorney General	1,202	\$ 67,825,400	\$ 6,785,000
Education	425	752,371,100	16,793,300
Government Services	528	36,303,200 ¹	3,025,000 ²
Vocational and Technical Training	1,126	57,606,000	12,357,000

¹There is an additional \$24 million of expenditures incurred by this Department, and charged to others.

²These are the capital expenditures of the Department itself, and do not include those of other departments, for certain of which Government Services acts as project manager.

Need for Policy and Direction

Our review clearly revealed the need for an enhanced audit presence in most departments of government including those currently with an internal audit function as well as those without it. Fundamental to such enhancement, however, is the requirement for a detailed policy statement by Government on the role of internal audit as part of the management control structure.

There has been a growing public concern that governments ensure that maximum benefits and value for tax dollars are received. This resulted in policies being issued in provinces such as Ontario and British Columbia which require:

- a strong internal audit presence throughout Government;
- a mandate that provides a much broader scope of audit activity, especially relating to evaluating for value-for-money through the economic and efficient utilization of resources;
- a structure which positions internal audit within the organization at a level appropriate to permit its independence from those it must audit, while ensuring that it remains accountable to senior management; and
- experienced and qualified individuals to perform complex auditing assignments.

Need for Expanded Audit Scope

We expected auditors to be in a position where they would be able to choose the activities to be audited, and that all major areas of the Department would be scheduled for audit on a regular basis. We further expected that audits would include both financial and non-financial aspects, including the appraisal of the economy and efficiency with which department resources were utilized.

Based on evaluations of internal audit groups in other enterprises, the most worthwhile activity of this function in recent years has been in assessing economic and efficient utilization of enterprise resources. In the five Departments where job descriptions for internal auditors included provisions for economy and efficiency audits, the majority of

their work concentrated on financial and compliance audits. Contributing to their inability to undertake more work of an expanded scope nature have been time and staffing constraints, as well as training and experience limitations.

Need for Planning and Risk Analysis

We found the audit planning that did take place was limited to the short term, with no long-range audit plans prepared. There was no formal department-wide analysis to permit identification of all areas that should be subject to audit and assessed according to importance to management, with emphasis on materiality and degree of risk or exposure. In addition, we found audit programs in most instances did not include provision for review of economic and efficient use of resources. Too much emphasis was placed on financial areas and auditing for compliance to policies and procedures.

In our view, internal audit groups must plan in a manner that provides audit coverage of key items on a regular basis, and ensures that all other areas are examined on a longer cyclical basis.

Need for Central Internal Audit for Smaller Departments

In addition to those departments currently with or requiring a full time internal audit function, there are others with varying requirements for some part-time or shared audit resources.

In our discussions with Deputy Ministers and other senior officials, it was determined that a full time internal audit function would not be required in all departments. We found they strongly supported the establishment of a central internal audit group that would be able to provide service to these departments in areas of concern to management. We made suggestions for its structure and where it could be considered for implementation.

Other Issues

Other issues of a significant nature were noted, and suggestions for improvement to these were made. These included the need for:

- a status within the organization appropriate to assist in providing independence and objectivity;
- a formal written mandate known throughout the organization;
- appropriately qualified individuals in the internal audit positions;
- assistance for auditors in maintaining professional competence, especially for audits of computer systems and reviews for economy and efficiency of operations; and
- improvements in the performance of the audit work and in the reporting process.

Benefits Noted

Where an internal audit function was operating, distinct benefits were received by the department, including:

- objective evaluations of departmental controls, both financial and administrative;
- increased assurance that expenditures were made in compliance with legislative and other requirements;
- where there were decentralized operations throughout the Province, an evaluation of compliance with departmental policies and procedures; and
- a catalyst in promoting improved operating performance.

Furthermore, two particular departments with no internal audit, Health and Municipal Affairs, have other groups which provide senior management with essential information. These groups assess the operations of entities outside the Provincial Government, to which large amounts of departmental funds are granted. Thereby a reasonably effective degree of accountability is achieved by this knowledgeable and independent review process.

Concluding Comments

This was the first time we reviewed the internal audit function in all departments of the Government. On the basis of this examination, we observed several significant conditions.

- Five departments (Development, Finance, Housing, Social Services, and Tourism) with internal audit showed general conformity to the evaluation criteria. We did, however, make recommendations for ways in which they could improve their performance and effectiveness.
- The Department of Transportation has a group referred to as internal audit that is essentially an internal control function. It is not what we would consider to be internal audit.
- Four departments without internal audit should have it as part of their management control structure. These are the departments of Attorney General, Education, Government Services, and Vocational and Technical Training.
- The departments of Health and Municipal Affairs, with no formal internal audit function, have groups performing many of the activities that would be expected of an internal auditor.
- There were eight departments that were not large enough to warrant a full time internal audit or review function. These were Agriculture and Marketing; Consumer Affairs; Culture, Recreation and Fitness; Environment; Fisheries; Labour; Lands and Forests; and Mines and Energy. Nonetheless, they could benefit immeasurably from the availability of a shared service.

It is our position that internal audit is essential as an accepted, necessary and integral part of the management process. It has often been under-utilized perhaps due to a misunderstanding of its role and benefits. This has been especially so in the evaluation of the economic and efficient utilization of resources.

Two fundamental issues emerged from our audit which should be dealt with.

- An overall policy statement on the roles and responsibilities of internal audit throughout the Government of Nova Scotia is required.
- There is need for an expanded audit scope, beyond financial and compliance issues, to include the economic and efficient use of resources.

Expenses of Members of the House of Assembly, Members of the Executive Council, Deputy Ministers and Equivalents, Ministerial Assistants and Judges of the Provincial Magistrate's Court

Introduction and Background

In my 1984 Annual Report, I commented on the results of our review of the travel, accommodation, and related constituency expenses of all Members of the House of Assembly, for the period January 1, 1982 to June 30, 1983.

The objective of that audit was to determine whether the expense claims of the members were prepared in accordance with the provisions of the House of Assembly Act, the Executive Council Act and related regulations. This audit report was issued to the Speaker in November 1983.

In addition, we reviewed travel and other expenses of the Members of the Executive Council, Deputy Ministers, and ministerial assistants for the fiscal year ended March 31, 1983. The objective of that audit was to determine if claims were reasonable, properly authorized and documented, and where applicable, in accordance with the established guidelines for expenses of public servants of the Province. The report on this assignment was issued to the Chairman of Management Board in January 1984.

The principal findings in these two reports, which described the condition at the time of our audit in 1983, may be summarized as follows.

- There were many deficiencies with respect to the adequacy of supporting documentation and explanations for expenses claimed, which often made it impossible to determine whether the expenses were eligible for reimbursement.
- The regulations of the Legislature Internal Economy Board, which describe constituency expenses that members are entitled to recover, were inadequate in portraying the extent to which certain expenses were claimable.
- The Speaker's Office did not have sufficient staff to adequately review expense claims.

- There was inadequate disclosure of members' expenses in the Public Accounts. Details of payments to members for annual indemnities, committee fees, and House-related and constituency travel expenses were not reported separately.

Subsequent to the release of these reports, Government initiated corrective action regarding regulations and guidelines, and administration of the function. Accordingly, in early 1985 I was in a position to express the following conclusions and recommendations in my 1984 Annual Report.

- A revised statement of travel policy was issued in Management Manual 510 — Personnel Management, in November 1984. This provided a comprehensive coverage of travel policies and payment allowances for all public servants, and dealt satisfactorily with our audit conclusions and recommendations relating to ambiguities and incompleteness.
- The Legislature Internal Economy Board approved a set of policy guidelines for Members' indemnities, allowances, expenses and reimbursement, to supplement a regulation issued in December 1984 relating to expenses of Members of the House. These guidelines have been published by the Speaker's Office, and briefing sessions have been held to explain them to Members of the House.
- The revised Regulation and guidelines, as well as the improved procedures in the Speaker's Office, should provide for the adequate administration of this function. Moreover, those responsible for administering the approval and disbursement process must ensure there is compliance with the eligibility, documentation, and explanation requirements of the Regulation and guidelines.
- It is essential that regulations, guidelines and Management Manual Bulletins relating to travel expenses be made public, and steps be continued to explain the definitions, conditions, and entitlements contained therein. Moreover, the administrative processes relating to expense payments and reimbursement procedures should be clearly explained to all concerned on a regular basis.

- Details of indemnities, allowances, committee fees and other stipends received, travel expenses for constituency and committee work, and office and other constituency related expenses should be reported each year in the Supplement to the Public Accounts.

Purpose and Scope of 1986 Audit

The purpose of the current year's audit was to assess the suitability of the revised new guidelines and Management Manual Bulletin; and the effectiveness of the procedures implemented in the Speaker's Office and the Department of Finance.

Our audit included a review of travel and other expenses of Members of the Legislature, Members of Executive Council, Deputy Ministers and equivalents, ministerial assistants and Judges of the Provincial Magistrate's Court for the period April 1, 1985 to March 31, 1986.

The objective of our audit of members' expenses was to determine if claims were prepared in accordance with the provisions of the House of Assembly Act, the Executive Council Act and the related regulations. Our objective for the other four groups was to determine if claims were reasonable, properly authorized, adequately documented, and in accordance with established guidelines.

Two reports were issued on the basis of this audit — one to the Speaker of the House of Assembly regarding expenses of Members of the House, and one addressed jointly to the Minister of Finance and the Chairman of Management Board concerning expenses of Ministers, Deputy Ministers and equivalents, ministerial assistants and Judges of the Provincial Magistrate's Court.

Concluding Remarks

My opinions on the principal matters reported to the Speaker of the House, and to the Minister of Finance and Chairman of Management Board are presented in the following paragraphs.

- The regulations and guidelines under the House of Assembly Act for members' travel and constituency expenses, and those under the Executive Council Act for expenses of outside Members of Executive Council have been significantly revised. It is my opinion that these regulations and guidelines are satisfactory and fully appropriate for these expense classifications.
- Actions taken by the Speaker and the Legislature Internal Economy Board shortly after our last audit to institute an improved review and approval process, and disseminate information about the process to Members of the House, have effected a notable improvement in accounting for members' expenses. It is my opinion that the administration of this function by the Speaker's Office is being properly performed.
- Existing Management Manual guidelines for Members of the Executive Council, Deputy Ministers and equivalents, ministerial assistants and Judges of the Provincial Magistrate's Court are adequate in that they provide a clear definition of allowable expenses and documentation requirements.
- The review process at the Department of Finance, which covers all expense claims submitted for payment, is functioning satisfactorily.
- We investigated all instances of questionable expenses, inadequate documentation or explanations, as disclosed both by the staff reviews in the Speaker's Office and the Department of Finance, and by our audit. In all cases, our subsequent review has resulted in satisfactory documentation or explanation being provided, or recovery has been received.
- Apart from those noted above, we concluded that the original documentation and explanations submitted to support expense claims were adequate.
- The Statement of Travelling Expenses form, presently used by Ministers and public servants, does not require sufficient detail to facilitate its review for reasonableness by those approving or auditing it, and accordingly should be revised.

The Department of Finance is revising the Statement of Travelling Expenses form, to require more detail. In addition, the Statement of Travel and Living Allowances form, used by Members of the House, is being modified somewhat to improve its effectiveness.

Arrangements have been made to provide the degree of disclosure of expenses recommended in our previous report. Additional information will be published in the 1986 Supplement to the Public Accounts.

- For all members, there will be reported their annual indemnity and expense allowances, committee fees, statutory salaries, postage and travel allowances and other constituency expenses.
- In addition, for all Ministers, there will be reported their living allowances and departmental travel expenses.

In summary, it can be stated that the relevant regulations, guidelines and procedures are appropriate, documentation and explanations received are satisfactory, and the two review and approval processes are functioning properly. However, in view of the nature of expense claims, it is essential that the level of support documentation be maintained and, so as to ensure their reasonableness and compliance with authorities, that there be no relaxation of the monitoring of them.

Department of Vocational and Technical Training Vocational Schools

Introduction

Until November 1985, regional vocational schools in the Province were administered by the Department of Education. A new department, eventually called the Department of Vocational and Technical Training, was created and made responsible for administering the sections of the Education Act pertaining to vocational schools.

There are 14 regional vocational schools in the Province. The cost of operating these schools was over \$27 million for the fiscal year ended March 31, 1986. Eleven of the regional vocational schools come under the direct supervision of the Department, while the other three are administered by local district school boards.

On a cyclical basis our Office reviews the operations of schools under the supervision of the Department. These reviews concentrate primarily on accounting and financial controls, but during the current year we completed an audit of broader scope, the objectives of which were to assess:

- the management control systems in use;
- the procedures for reviewing and approving the curriculum of the schools;
- the systems utilized to hire teachers and monitor their performance; and
- the systems used for school facilities and materiel management.

Our examination included interviews with senior management of the Department, reviews of departmental information and reports, and visits to six of the schools which involved meetings with both administrative and instructional staff at these schools.

Since the establishment of the Department of Vocational and Technical Training, regional vocational schools are receiving a higher degree of priority. As a result, some of the areas that we reported upon are already being addressed; there was an awareness of most of the problems discussed in our report; and other worthwhile initiatives relating to vocational and technical training have been commenced.

The more important matters reported to management are presented under the following captions:

Management Control Systems
Curriculum
Human Resources Management
Facilities and Materiel Management

Management Control Systems

From our review of the operation of the management information systems used by both the Department and the schools to control their activities, we determined that:

- although there was a fair amount of financial and operational information available, it was not subject to regular analysis;
- financial information was not being related to levels of activity such as the number of students and size of the facilities, and analytical ratios were not being prepared;
- measures of activity such as course costs were not being compared among schools, or significant trends being determined;
- there were differences in account classification and costing methods being utilized by the schools in accumulating course cost data;
- numerous instances existed of non-compliance by the schools to required procedures in the Department's Administration and Management Manual; and
- there was evidence in the schools of internal control weaknesses due to an inadequate segregation of duties in the handling of cash, improper use of cash registers, and a lack of forms control.

We prepared and submitted to the Department some schedules showing cost and activity indicators by school. These included — cost per student per course, recovery of supplies costs, student-teacher ratios, and janitorial and maintenance costs on a square foot basis.

Our analyses of 10 courses showed the most expensive per student course cost was nearly three times that of the lowest. A similar comparison of student-teacher ratios for 10 other courses showed an average variation between highest and lowest of 116%. The 1983-84 costs per square foot for janitorial and maintenance costs for 7 of the 11 schools were within 10% of the median cost, but the four most expensive were from 40 to 200% higher than the median.

There may well be reasonable explanations for these variations. However, the important point is that these calculations had not been made, so management was not in a position to provide verifiable explanations for the differences.

It is our contention that such analyses and others which may be found useful, must be prepared on a regular basis, carefully analyzed to determine the reasons for significant differences (both favorable and unfavorable), and where necessary and possible appropriate corrective action initiated. We understand that this process will now be introduced.

The Department has no formal procedures to ensure that policies and controls for the operation of the schools and the use of provincial property are being adhered to. A Department of the diversity and magnitude of this one must have an independent appraisal function, such as internal audit.

Curriculum

The purpose of our review of this area was to assess how curriculum is being developed and evaluated.

We found that the curriculum for new courses was not being subjected to a meaningful review by the Department. The schools initiate the curriculum for the courses but rarely receive any feedback from the Department. We recommended that the Department review the curriculum for new courses, and also monitor the curriculum of existing courses to ensure consistency among schools.

The Department has begun using labour market statistics when assessing the need for future courses. We have encouraged the Department to continue using this information in its planning process.

As part of the evaluation of curriculum, the Department conducted a graduate employment survey on a sample of 1984 graduates from Nova Scotia Regional Vocational Schools. Their intentions are to have this survey done on an annual basis.

Some schools conduct their own graduate employment follow-up surveys. It is our contention that the Department and schools should work together to ensure the methods used are consistent, so as to reduce duplication of effort. These surveys are valuable instruments in assessing course quality, and when coordinated with other statistics can be a useful measure of how well the schools have trained students to meet employer needs.

Two other matters that the Department should consider implementing are student evaluations of courses and instructors, and the general adoption of admission tests or interviews for students. Both warrant consideration because they would contribute to improving the level of instruction, and identifying student suitability for given courses.

Human Resources Management

In this segment of our audit, we reviewed the systems for hiring new teachers, and maintaining and upgrading teacher qualifications. Our objective was to assess certain aspects of the Department's human resource management system.

There are more than 500 people employed in the Vocational Schools. Their related salary costs account for the majority of the schools' expenditures. We examined the information system that regularly provides information on the activity and qualifications of these resources.

In overview, it can be concluded that the Department did not have an information system or data base appropriate to the administrative requirements for human resource management. Reference has been made regarding the lack of operational information, such as student-teacher ratios. In addition, the practices relating to performance appraisals were found deficient.

Statistical analysis, such as student-teacher ratios, is not used regularly, but employed only by senior management for special situations. There is need for this type of information for a continuing assessment of the efficient use of teaching resources. Also, the Department does not analyze teacher certificate levels and potential retirement dates to plan in advance for retirements and associated costs.

The Department does not have a policy regarding the appraisal of teachers and principals. At present the performance of teachers is not being assessed by senior school management in a consistent manner, and school principals are not evaluated on a regular basis. Consequently, each school has instituted different appraisal methods.

The Department does not have a policy regarding additional training for teachers. We circulated a questionnaire on training updates to 60 randomly selected teachers. Of those responding, 90% indicated the need for more training updates than presently available. They requested that better liaison with industry be established, especially for trade course teachers. The respondents also signified that previous technical updates were beneficial to their teaching duties.

Facilities and Materiel Management

The Department of Government Services performs a landlord function for those schools under the supervision of the Department of Vocational and Technical Training.

We determined that the operating costs of facilities are not monitored on a regular basis by such means as calculation of the cost per square foot per school for janitorial and maintenance costs. We calculated these costs on a square foot basis for all vocational schools, and found that the costs varied considerably among the schools. Although reasonable explanations are likely available for most of these differences, sound facilities management would dictate a process which includes cost calculations, analysis of significant variations and appropriate corrective action when possible.

Neither Vocational and Technical Training, nor Government Services had adequate information on the frequency or results of fire inspections conducted at the schools. These should be monitored to determine what action is required to ensure all necessary fire precaution steps are implemented.

Our review of materiel management systems indicated that adequate systems and controls are in effect.

Conclusions

Our audit was performed within months of the formation of the new Department of Vocational and Technical Training. Accordingly, it must be recognized that the conditions we have commented upon prevailed during the period that those schools were administered by the Department of Education. Also, it is apparent that the newly formed Department has not had time to resolve those matters we have discussed in this report. We acknowledge their awareness of them, and efforts to introduce more appropriate and effective management practices.

Three principal conclusions were derived from our audit.

- To provide appropriate management control information, there must be an upgrading of data accumulation and analysis, including the preparation of activity measures such as comparative course costs, student-teacher ratios, and facilities' costs.
- The development and monitoring of curriculum practices require enhancement and coordination.
- Aspects of human resource management relating to basic data on staff, professional development and performance appraisal are in need of improvement.

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**OTHER
AUDIT
OBSERVATIONS**

Introduction

During each year, my Office performs many audits in the departments of government, reviewing their accounting and financial systems and examining transactions. The extent and variety of these audits may be seen by a reading of Appendix II to this Report, which tabulates the 45 audits performed in 19 departments during the current audit year.

These audits are done to fulfill the audit mandate of Section 7 of the Auditor General Act. Section 8 of the Act requires that I report certain specific items that come to my attention during these audits. This requirement is met by what is included in this section of my Report and in the article on Additional Appropriations, page 50.

The articles under this caption "Other Audit Observations" may be termed "reporting by exception", discussed briefly in the Introduction section of this Report.

Cash and Other Losses

Pursuant to Section 8(1) (e) of the Auditor General Act, I report the following incidents of "deficiencies or losses through fraud, default or mistake of any person", covering the fiscal year ended March 31, 1986.

Department of Attorney General

There were five minor cash losses during the fiscal year totalling \$105, with no convictions or recovery.

Nova Scotia Commission on Drug Dependency

Two thefts resulted in the loss of audio visual and office equipment valued at \$6,880. Some of the equipment was insured and \$3,900 was recovered. A police investigation was carried out but no arrests were made.

Department of Education

The Department sustained three cash losses totalling \$303 and six equipment losses totalling \$12,674. Included in the equipment losses was \$5,175 worth of video and other equipment taken from the Dartmouth Regional Vocational School, and equipment valued at \$6,377 taken from the Adult Vocational Training Centre in Sydney. There were no convictions or recoveries in any of the losses.

Department of Environment

An employee was convicted of fraud in excess of \$200 for receiving snow removal services at his residence and charging the costs to the Department. There was no recovery, however, the employee was discharged from his duties.

Department of Municipal Affairs

Office equipment valued at \$1,920 was stolen from head office. A police investigation was carried out but there were no arrests or recovery.

Office of the Ombudsman

A cash loss of \$36 was reported. No recovery was made.

Department of Transportation

There were 22 instances of loss or theft of departmental equipment, in various locations throughout the Province. The estimated loss was \$8,400 with subsequent recovery of only \$820.

The Englishtown Ferry Operation and the Kelly Lake and Enfield Scale Houses sustained cash losses of \$268 and \$620 respectively, with no recoveries made. Another cash loss of \$12 at the Enfield Scale House was subsequently recovered.

Victoria General Hospital

A break and enter resulted in the loss of \$1,448. Investigations were carried out by police and the hospital's security officer, but no arrests or recoveries were made.

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Management Manual Bulletin

Annual Reports of this Office for 1981 and 1982 pointed out the need for revision to the 1964 Management Manual Bulletin dealing with actual or suspected losses.

In my 1985 Report, it was noted that the Department of Finance had prepared a revised bulletin which we reviewed and found both appropriate and necessary. Over a year ago, it was submitted to Management Board for inclusion in the Government of Nova Scotia Management Manual.

Unfortunately the "early implementation" of this revised bulletin which I had anticipated in my 1985 Annual Report has not taken place. Again I point out the need for its release so that procedures relating to the handling of detected or suspected fraud are available to departments and agencies of government for reference and guidance.

Computer Related Audits

Introduction

In previous years, this Office has reported the results of our audits of computer systems and controls. These assignments are carried out in departments and agencies where computerized systems are utilized for accounting, financial, and other management related activities. They include the review and evaluation of general environment controls and processing controls.

The review of general environment controls relates to procedures for the management and use of computer resources and covers areas such as:

- organization of the computer activity;
- controls over development and maintenance of systems;
- controls over the operation of systems, processing of data, and security of computer resources; and
- documentation of systems and programs.

The review of processing controls covers the specific procedures, whether computerized or manual, relating to the individual systems. These controls are intended to ensure the completeness and accuracy of the data processed, and the adequacy of authorizations and audit trails.

Regular Audit Reviews

During the past year, as part of our regular audit coverage, we performed update reviews of the computer operations and systems at the following departments and agencies.

Department of Consumer Affairs
Halifax Infirmary
Victoria General Hospital
Camp Hill Hospital
Nova Scotia Research Foundation Corporation

We noted improvements in the level of controls in comparison to the results of earlier reviews. However, certain weaknesses remain, summarized as follows, some of which were common to various sites:

- inadequate controls or standards established for development and maintenance of systems and programs;
- inadequate segregation of development and maintenance activities from existing programs and data;
- disaster recovery and contingency plans not developed or tested;
- inadequate arrangements for off-site storage of backup programs and data;
- incomplete documentation, and inadequate standards for the preparation and maintenance of documentation;
- inadequate password systems to control access to data and programs;
- no independent verification of changes to master file data; and
- inadequate audit trails.

These matters have been reported to management, and in most instances they have indicated intentions to deal with them.

Also arising from these update reviews are three significant matters that must receive management's immediate attention, and hopefully appropriate corrective action where possible. These are:

- control of access to systems
- segregation of development and maintenance activities from existing programs or data
- development and testing of disaster recovery and contingency plans.

In addition to the above updates, we carried out brief status reviews of two major systems presently under development.

Registry of Motor Vehicles
Licenses and Registrations System

Victoria General Hospital
Hospital Management Information System

Both represent significant additions or changes to the existing computer systems. This Office will review these systems in more detail at a future time.

Cyclical In-depth Reviews

The balance of this article summarizes the results of in-depth reviews performed at two of the Province's major computer sites, namely the Departments of Social Services and Finance. The last such reviews were completed and reported on in 1983 and 1984, respectively. The objectives of the current assignments were to evaluate both the general environment controls surrounding the computer installation, and the processing controls for these two systems.

Social Services — The Department of Social Services relies extensively on computerized systems to manage its financial assistance programs. This reliance, and the overall complexity of its computerized systems are increasing. The Department has been converting and integrating assistance programs to a new on-line system. There will be increasing use of on-line inquiry and updating. In addition, responsibility for the data entry function has been decentralized to two regional offices. Other offices are scheduled for decentralization in the future.

We generally concluded that the Department's computer operations and systems are well organized, managed, and controlled. Our recommendations to management were directed at enhancing the level of control in specific areas, especially password access security and controls, and disaster recovery and contingency planning.

Finance — The Department of Finance relies extensively on computerized systems in managing and controlling the centralized financial records of the Province. Their computer resources include a minicomputer and various computerized systems for the general ledger and disbursement accounting functions. Other financial systems currently under development include the debenture administration and investments systems.

The Department has made progress in implementing its plans for decentralizing the data entry and reporting functions to the operating departments. The number of departments performing their own data entry and inquiry has increased significantly. At the time of this review, 22 departments and agencies were involved in this process.

Overall, we were pleased to note the changes and improvements management has implemented since our last review. However, certain weaknesses, especially relating to password access security and controls, remain to be addressed. As the Department's reliance on computer resources and systems increases, there will be a corresponding increase in the degree of risk inherent in these control weaknesses.

These in-depth reviews at Social Services and Finance indicated the existence of two underlying conditions which are discussed further in the following sections.

Password access security and controls

The implementation and maintenance of an adequate level of password access security and controls is essential to the ongoing integrity of the Province's information systems. Our reviews indicated that improvements should be made in the level of password access security and controls at these two departments.

There should be controls in place to ensure that all access to computerized systems is authorized and in accordance with established policies. The use of security software to control access to computerized data files and programs is generally accepted as a minimum control standard. Ideally, this would involve the use of unique user identification and password codes to control access.

The security software arrangements used by Social Services do not restrict the number of attempts to access on-line data and functions. Also, no audit trail is generated of successful and/or unsuccessful attempts to access the systems. The Department has indicated improvement in this area will be implemented within the next year.

At Finance there is an inadequate segregation of duties due to the access privileges of several members of the Department's Management Information Systems Division. Changes are to be made, but there are some practical and technical limitations to the level of access security

and controls that can be achieved. More emphasis will have to be placed on management review and alternative procedures to achieve an appropriate level of control.

In light of the number of staff accessing the Department's systems, formal security policies and guidelines should be established and communicated to all users of Finance's systems.

Disaster recovery and contingency planning

The review we performed at Social Services identified a condition relating to disaster recovery and contingency planning which warrants further comment.

There should be procedures documented and tested to ensure that computer systems processing can be recovered and resumed after operations have been interrupted. These procedures should deal with interruptions ranging from temporary loss of normal processing at a system or facility level, to the prolonged loss of processing capabilities and resources.

Social Services' management is aware that a loss of access to or use of its computer resources would seriously impair the ability of the Department to function. Procedures have been defined for selected areas, dealing only with the temporary loss of processing capabilities. In our view, further effort is required in the area of disaster recovery and contingency planning for a more prolonged loss.

Subsequent to the completion of this assignment, the Department of Government Services undertook a project to assess the need for, and to develop, disaster recovery and contingency plans for critical systems processed through the Province's data centre. Since most of their computer processing is performed through the centre, Social Services is participating in this project.

Concluding Remarks

Improvements have been made in the overall level of controls over computer resources and systems. However, further efforts are required to enhance and maintain both the level and consistency of controls throughout the Province's computer operations.

A number of significant systems are being planned or developed which will result in more decentralized use of processing capabilities by departments and agencies. As a result, integrity of the security and controls over computer systems will continue to be a critical concern.

In the next year, in addition to regular reviews of computer related matters, this Office plans to undertake a number of studies evaluating selected information processing controls and procedures on a government-wide basis.

Department of Development

Non-Compliance with the Industrial Development Act

In 1982, the Industrial Expansion Fund guaranteed a \$2.8 million bank loan on behalf of a shipyard. The bank loan financed the conversion of a fishing boat, damaged by fire, to an offshore standby rescue vessel. The conversion was completed but the shipyard was placed in receivership, resulting in the Province having to honour the guarantee and take ownership of the boat.

In December 1985, Order in Council 85-1432 authorized the sale of the vessel for \$3 million. The sale was to be financed by a mortgage of \$2.5 million from the Industrial Expansion Fund, and a cash payment of \$500,000 from the purchaser at the closing.

The purchaser was unable to make the required \$500,000 payment. In January 1986, an agreement was signed between the Department of Development and the purchaser, which provided for a mortgage of \$2.5 million and an interest free loan of \$500,000.

The total financial assistance approved for purchase of the vessel in the January 1986 agreement was \$3 million. However, the Order in Council stipulated that the loan to the purchaser was not to exceed \$2.5 million.

Conclusion

Section 2(1) of the Industrial Development Act requires that financial assistance be subject to approval of the Governor in Council. The financing of the sale of this vessel is not in accordance with the Order in Council, which specifically limits the loan to a \$2.5 million mortgage. In those cases where there are substantial changes to an agreement approved by Order in Council, those changes should be approved or ratified by a subsequent Order.

Provincial Retirement Plans

Introduction

The Auditor General has the responsibility to audit annually both the Public Service Superannuation Fund and the Nova Scotia Teachers' Pension Fund. Each audit requires the expression of an opinion on the balance sheet and the statement of continuity of the fund. The audits involve a review of contributions received, investments, and pension payments made.

My Office is not required to assess the funds' positions in relation to future pension commitments. A qualified actuary performs this assessment, and actuarial reviews of the two funds are performed on a regular basis.

The actuarial valuation of a pension fund is a relatively complicated process. It involves mathematically forecasting future expectations for the pension plan, taking into consideration factors such as anticipated salary progression, estimates of inflation, the rate of return on invested funds, and probable rates of employee retirement, death or disability.

The actuary prepares an "actuarial balance sheet" which shows the present value of liabilities for pension benefits earned to that date for pensioners and for active employees still working, anticipated benefits payable for future pensioners, and expected refunds of contributions upon death or termination of current employees. From the total liabilities so calculated is deducted the current value of all investments in the fund at the date of the actuarial balance sheet. When these liabilities exceed the available assets, it represents an unfunded actuarial liability. This means the pension plan has commitments to be met in the future for which funding has not been provided.

The unfunded liabilities of both plans have been relatively large, therefore it has been the practice of this Office to comment on the results of the actuarial valuations in the years in which they are released. Extensive commentaries have been made in the 1977, 1981, 1982, 1983, and 1985 Annual Reports.

An actuarial report on the Teachers' Pension Fund was completed in October 1986, relating to the Fund's position at July 31, 1984. The most recent report on the Public Service Superannuation Fund was completed in June 1985, relating to the status of the Fund at June 30, 1984.

Teachers' Pension Fund

The Teachers' Pension Commission contracts for an actuary to perform a valuation every five years as required by the Teachers' Pension Act. An actuarial valuation of the Teachers' Pension Fund as at July 31, 1984 was performed and the report released October 1986.

The 27 month period between the effective date of the valuation and the completion of the report is too long. Salary reports received from School Boards are often not ready for actuarial review for almost a year. This is a consequence of an inappropriate pension accounting and information system used to generate data, both at the School Board level and at the Teachers' Pension Commission. Much of the system is manual, and the computerized portion was designed in 1977 with little upgrading since that time.

Studies have been conducted to determine the best approach to computerize the pension information system. The Commission has reviewed these studies and started the process of acquiring the necessary hardware and software. Present plans estimate the system could be operational by early 1988.

In my 1985 Report, I recommended that in view of the large unfunded liability and the time required to accumulate the data, actuarial valuations be done more often than at five year intervals. Since the computer system will not be operational until 1988, the next valuation is currently scheduled for 1989.

The results of the actuary's study indicate a continued increase in the unfunded actuarial liability. A summary of the last four actuarial balance sheets follows.

Teachers' Pension Fund
Summary of Actuarial Valuations
 (000's)

	1984	1979	1974	1969
Actuarial liabilities	\$1,127,125	\$679,532	\$296,430	\$132,146
Assets	<u>456,652</u>	<u>221,589</u>	<u>112,733</u>	<u>65,830</u>
Unfunded actuarial liabilities	<u>\$ 670,473</u>	<u>\$457,943</u>	<u>\$183,697</u>	<u>\$ 66,416</u>

The unfunded liability at July 31, 1984 is 46% higher than July 31, 1979. The principal reason for the increase is the compounding of interest on the unfunded liability because no action has been taken to reduce, or as a minimum "freeze", the unfunded liability at a set level. Ignoring other factors, to avoid further increases in the unfunded liability, there should be payments into the fund equal to the interest that could be earned on the unfunded liability amount. This is done in some jurisdictions. If this practice were followed for the Teachers' Pension Fund, payments of more than \$41 million annually would have been required since the last valuation in 1979. Since these payments were not made, it can be said that \$200 million of the increase in the unfunded liability over the five year period was due to the interest cost of carrying the unfunded liability.

Another major reason for the unfunded liability increase is that contributions to the Fund are not sufficient to meet the benefits currently being earned. The actuarial study indicates that an increase in total contributions of 7% is needed in order to pay for the benefits being earned. This is due to improvements in benefits being granted without adequate compensating increases in contributions to pay for them.

When benefit changes are made to the Plan, the cost impact of these changes should be computed, and fully funded by contributions. All increases in benefits should be paid for as earned, and not deferred to future periods.

Two other matters of importance from the actuarial report relating to the operation of the Fund should be noted. The actuary includes among his recommendations the statement that *"The Province consider a change in investment policy in order to increase the yield on the Fund"*. In addition, he notes the need for a cash flow study to be undertaken in conjunction with the next actuarial review. The last cash flow study was performed in 1983.

Public Service Superannuation Fund

My 1985 Annual Report includes a tabulation of the principal conclusions from the June 30, 1984 actuarial report, which was completed in June 1985. These conclusions are summarized below.

- The unfunded liability at June 30, 1984 is \$252.5 million, an increase of \$6.4 million over the three year period since the last actuarial valuation.
- The actuarial balance sheet shows that the unfunded liability is 34% of the present value of the liabilities calculated at the balance sheet date. This compares with an unfunded liability of 45% of the total liabilities at June 30, 1981, a fairly significant improvement.
- Contributions to the Fund exceed the costs of benefits being earned by 1.83%, an improvement over a deficiency in contributions of 1.38% in 1981. This excess is available to reduce the unfunded liability.

The actuarial valuation at June 30, 1984 was three years after the date of the previous actuarial study. We support the decision to conduct these reviews at three year intervals rather than the prior frequency of five years, because of the possibility of substantial change in the key variables of benefits, contributions, and fund earnings.

Conclusion

There appears to be a stabilization of the unfunded liability of the Public Service Superannuation Fund. This stabilization is due to the increase in real return on funds invested, and the excess of current premiums over benefits earned.

Regarding the Teachers' Pension Fund, I repeat some of the concerns expressed previously.

- Current contributions from teachers and government are insufficient to meet the costs of the benefits currently being earned.

- Actuarial valuations should be performed more frequently than every five years. A three year interval would appear to be more appropriate.
- The interval between the actuarial balance sheet date and the completion of the actuary's report is too long. Required computerization of the pension information system should be made, to improve the quality of the data used and the timeliness of actuarial reports.

The unfunded liabilities of both retirement plans are matters of some concern, particularly in the Teachers' Pension Fund because of the magnitude of the increase over the past ten years.

There are differing points of view concerning the need to fund completely, partly or indeed at all, liabilities for pensions in the government sector. Recent actuarial reports for both provincial retirement plans suggest that it is not unreasonable to carry some degree of unfunded liability in mature and stable pension funds such as those of a province.

It must be pointed out, however, that increases in unfunded liabilities will result eventually in a situation where benefits earned to date will have to be met from future revenues or contributions. This deferment of cost, for payment by some future generation of taxpayers or contributors, is one that must be minimized and if possible reduced from present levels.

Reservations of Opinion

The provisions of Section 7(b) and (d) of the Auditor General Act assign to me the responsibility for ascertaining whether in my opinion:

- all revenues to which the Province is entitled have been received, and that there are adequate systems and procedures to administer the revenue collecting function; and
- essential records are maintained and the rules and procedures applied are sufficient to safeguard and control public property.

To carry out this responsibility, it is necessary to review and evaluate the financial and accounting controls in the departments of Government. Should certain controls be found inadequate, these inadequacies must be considered in rendering an opinion.

The following paragraphs describe those instances where it was not possible to express an opinion that the existing records, controls and systems were adequate.

Public Trustee

There is an inadequate system to account for assets other than cash and securities under the administration of the Public Trustee. These include assets which are not in the physical possession of the Public Trustee but for which he has administrative responsibility. There is no system which records these assets at acquisition and reflects all changes in their status, in a manner which would provide adequate control over their disposition and use.

This year we performed a more detailed test for completeness of the accounting records. We identified 19 situations where assets totalling \$534,883 were not recorded in the accounting records as at March 31, 1986. These assets consisted of real estate, vehicles, household articles and personal effects.

This is a condition which was first brought to the Department's attention in our audit report for the fiscal year June 30, 1980. As the scope and size of the Public Trustee's operation has grown, these types of assets are now relatively significant in amount, and the situation must be viewed as serious.

Accordingly, it was necessary to express a qualified audit opinion on the balance sheet of the Public Trustee at March 31, 1986. This qualification read "*... there is no system to record trust assets that are not in the physical custody of the Public Trustee. As a consequence, I was unable to satisfy myself that all trust assets and liabilities of the Public Trustee had been recorded.*"

Corrective action on this matter has been commenced by the Department of Attorney General but, at the time of our Annual Report, there have been no significant developments regarding the necessary staffing and systems improvements required for a resolution of the situation.

Cancer Treatment and Research Foundation of Nova Scotia

We found the accounting systems and controls at the Foundation to be generally well designed. However, there were two serious weaknesses in internal control. Invoices are not serially pre-numbered, and there is a lack of segregation of duties between the billing function and handling of cash receipts. Because of these weaknesses, we were not able to express an unqualified opinion on the accounting systems.

Nova Scotia Lottery Commission

The controls over the cash receipts system for lottery licenses were inadequate due to the lack of proper segregation of duties. One person performed incompatible duties relating to the opening and recording of mail receipts, the posting of ledgers, and the preparation and making of bank deposits.

Due to these inadequacies, we were not able to express an unqualified opinion on the completeness of revenues from lottery licenses. This weakness was a result of staff shortages, since corrected.

Victoria General Hospital

This year, as was the case in the prior three years, deficiencies in controls over the laboratory and referred-in revenues existed. As these weaknesses have not been remedied, it again was not possible to issue an unqualified audit report for the Hospital.

Venture Corporations Board

Introduction

The Venture Corporations Board, a Provincial Government Crown Agency set up to administer the Venture Corporations Act, is empowered to recommend to the Minister of Development, the granting of unsecured loans to private sector venture capital corporations. The Board provides an unsecured loan to the venture corporation, matching its equity, and the total of these funds is invested in a small business company known as an eligible investment.

There are numerous provisions for qualification both as a venture capital corporation eligible to obtain a Board loan, and as a small business to receive funding from the Board and a venture corporation. Significant provisions of the Act are that the Board loans are not repayable for ten years, are interest free during that period, and interest or principal payments after the ten year period are contingent upon availability of profits.

My Reports for 1984 and 1985 contained comments on the Venture Corporations Board. The principal matter discussed was the lack of sufficient information from those receiving Venture Corporations Board equity loans:

- to ensure that the provisions of the Act are adhered to, and that loans are being used for the purposes agreed upon; and
- to establish an adequate provision for doubtful accounts in the financial statements of the Industrial Expansion Fund where the loans of the Board are reflected.

Consultants' Study

The Board engaged a firm of Chartered Accountants to review the Venture Capital Program to determine if it was meeting its original objectives, being effectively operated, and whether there was a need to continue the program. The report was completed in October 1986. The overall conclusion was that the program had met its basic objectives by creating a risk capital pool, spreading managerial assistance, and underwriting the risks associated with financing small businesses.

Forty-two companies have been registered as venture capital corporations. These corporations have provided a total investment in Nova Scotia businesses of \$17.7 million, which includes \$8.8 million in loans from the Board.

The consultants reported that 17 of the registered venture capital corporations were active venture companies in the sense envisaged by the program. Eleven companies appeared to have been established to support one specific business and there was no indication that they would be making additional investments. Of the remaining venture capital corporations, one half were either defunct or had specific problems, and the other half had only recently been established.

Two issues commented on by the consultants were:

- the use of circular financing; and
- the large degree of managerial control exercised by some venture corporations over their investments.

Circular financing occurs when the funds invested in an eligible investee do not originate with a venture capital corporation, but rather with the eligible investee itself. This takes place when an eligible investee initially provides funds to a venture capital corporation, so that the latter has the equity to qualify for a Venture Corporations Board loan. When the Board loan is obtained, and the total of it and the venture corporation's funds is advanced to the investee, in reality half of this total could be the investee's original funds.

The consultants recommended the need for clarification regarding the Board's approval of circular financing. Subsequently, the Board has adopted a policy which clarifies the circular financing circumstances which will be acceptable under the Act.

The consultants noticed a number of situations in which the venture capital corporation was taking a very active interest and involvement in the operations of the investee. They believed that this practice was inconsistent with provisions of the Act, which seem to intend that the corporation provide only business and managerial expertise. Certain shareholder agreements appeared to enable the venture capital corporation to override the intent of the Act. Accordingly, they recommended that the Act be amended to allow the practice of more active involvement.

Loan Monitoring and Valuation

The consultants pointed out that having the Venture Corporations Board review the worthiness of investees is inconsistent with true venture capital. The Board's ultimate objective is to base loan decisions on the financial soundness of the venture capital corporation. Nevertheless, I concur with the consultants' observation that few if any of these corporations have a track record and, until a successful record is established, they should expect a fairly rigorous screening before new loans are granted.

Thus, because of the amount of funds involved, the risky nature of the businesses, and the interest free and lengthy terms of the loans, there is a need for extremely diligent monitoring of these loans to ensure they are used for the purposes intended.

The Board obtains information on the activities of the venture capital corporations under Sections 15 and 16 of the Venture Corporations Act. These sections require the annual submission of information returns and financial statements. This information is necessary to assess the activities of the corporations and the potential for recovery.

In December 1986, my Office examined the files for 29 venture corporations which were required to submit the prescribed documents. Seventeen of these had not remitted the annual information returns or financial statements, within the prescribed time limit. Our tests also indicated that four corporations were in violation of Section 8 of the Act. This section requires that the venture capital corporation must, at given points in time, maintain specified levels of equity and amounts of investment in eligible investees.

Without obtaining the annual returns and financial statements required under the Act, the Board cannot be assured that the venture loans are being used for the purposes intended, nor can they adequately assess the ultimate collectability of these loans.

At March 31, 1986 the Venture Corporations Board had advanced \$8.6 million. An allowance for doubtful accounts of \$4 million had been provided for. The allowance consists of a full provision for loans known to be uncollectable, plus a partial provision against all other loans. This is necessary because of the high risk nature of the venture investments, and the ten year interval between disbursement of a loan and the commencement of repayments.

Conclusions

One of the overall conclusions of the consultants was the need for continued support of financing through the Venture Capital Program. In light of the consultants' comments and my own observations, the Board must fulfill the following responsibilities.

- The venture capital corporations, and their investments, should be subject to regular monitoring to ensure the funds are being used for the purpose for which they were advanced. The timely submission and review of annual information returns and financial statements is an essential part of this process. Until a venture capital corporation can demonstrate a successful investment record, rigorous screening of potential investments must continue.
- The Board must include an allowance in its accounts that adequately provides for potential losses due to the inherent risks of these loans.

* * * * *



**STATUS PRIOR YEARS'
OBSERVATIONS
AND
RECOMMENDATIONS**

Introduction

To provide a reference indicating the action taken and progress made on observations and recommendations from previous years' Annual Reports, a new section is included in this year's Report.

All important topics from the past five years' Reports, 1981 to 1985 inclusive, have been tabulated in a manner which presents briefly the observation or recommendation, its current status, and a page reference to the Report article. It is my intention to include this schedule in future Reports, but those which have been resolved will not be reflected again.

The status column reflects action taken by the agencies and departments of government to the time of preparation of this year's Report, as known to us on the basis of audits conducted this year or inquiries made. The sequence of the items is intended to approximate their position in the current Report.

There are 54 topics to be found on the tabulation, and the following summarizes their current status.

Comment still applies, or recommendation not implemented	22
Recommendation partly or substantially implemented	14
Recommendation fully implemented, or condition no longer applies	12
Status to be ascertained at a subsequent audit	<u>6</u>
	<u>54</u>

It is apparent that a substantial number of issues are not being addressed, or resolved in a manner which satisfies the views of this Office. Accordingly, a procedure to establish a more formalized follow-up process, as a suggested role for the Public Accounts Committee, is worthy of consideration and implementation.

Summary of Previously Reported Recommendations and Observations

Scope of Examination

- Office forced to operate substantially below full complement, due to delays in receiving approvals to fill staff vacancies.

Estimates

- Need to realistically anticipate all major expenditure requirements.
- Use of Results Indicators encouraged, and two specific examples described.

Status — at Preparation of 1986 Annual Report

Situation substantially improved in 1986.

Comment still applies in certain cases.

Government continues to have program in place, and status to be determined at time of a subsequent audit.

Reference
Year Page

1985 22
100-102

1985 25-26
1984 74
1983 29
1982 37-38

1985 26
1984 30

Summary of Previously Reported Recommendations and Observations	Status — at Preparation of 1986 Annual Report	Reference Year	Page
Public Accounts			
Serious accounting and disclosure deficiencies relating to the Statement of Current Revenue and Expenditure, and the Statement of Financial Position.	Substantial improvements were implemented in the 1983 Public Accounts, and acknowledged in Auditor General Annual Reports for 1983 and 1984.	1982 1981	74-79 52-56
Use of "Forecast" data in the Statement of Current Revenue and Expenditure, considered irrelevant and unnecessary.	Comment still applies.	1985 1984	28 32
Recommended more detailed disclosure of expenses for Members of the House of Assembly.	To be implemented in 1986 Supplement to Public Accounts.	1985 1984	28 66
Recommended the need for allowance in the Province's financial statements for possible losses on loan guarantees provided by Government.	Implemented in 1985 Public Accounts	1984 1983	32 42

- Certain advances under the Universities Assistance Act, which do not represent realizable recoveries from outside parties, are included on the Statement of Financial Position, contrary to prudent accounting practice.

Comment still applies.

1985 29

Auditor General Act

- Recommended amendments to the Act to provide an appropriate degree of independence, particularly regarding appointment of the Auditor General and administration of the Office.

Not yet implemented.

1985 31
1984 36-37

- Recommended extensions of the scope of the audit mandate for the Auditor General, especially for the audit of government grants and other assistance.

Not yet implemented.

1985 32-33
1984 37-39

- Other recommended amendments for administrative clarification and improvement to the Act.

Not yet implemented.

1985 33-34

Public Accounts Committee

- Recommendation for the appointment of an Opposition member as Chairman of the Committee.

Approved for implementation
1987 session of the House of
Assembly.

1985 35
1984 41-42
1983 46
1981 15

Summary of Previously Reported Recommendations and Observations	Status — at Preparation of 1986 Annual Report	Reference Year	Page
• Recommendation for various improvements in operation and structure of the Committee, relating principally to: — formal enunciation of Committee's role and responsibilities; — use of agendas, background material, and submission of a substantive annual report; — provision for follow-up to Committee recommendations; and — scheduling of Committee meetings when House not in session. • The need for more attention by the Committee to significant issues arising from both the Auditor General's Annual Report and the Public Accounts.	Not yet implemented.	1985 35 1984 41-42 1983 46 1981 15	41-42 46 15
	Substantial progress was effected in the 1985 and 1986 meetings of the Committee with the Auditor General. However, a more structured approach utilizing a more formal agenda and an annual committee report would help.	1984 41-42 1983 46 1981 15	

Financial Topics

- The need to reexamine existing government programs to evaluate their affordability and also their efficiency and effectiveness.

The strategic planning exercise, initiated in 1986, to review all government programs is a most commendable initial stage of evaluation.

1985 43
1984 81

- Additional appropriations are too frequently requested by departments, and approved by Executive Council after the end of the fiscal year, often six to eight months later.

Comment still applies.

1985 44,46
1984 74
1983 29
1982 80
1981 58

Crown Agencies and Corporations

- Recommendation that legislation is required for crown agencies and corporations to enhance their accountability by providing for consistent reporting and disclosure requirements, a definition of status, and related matters.

Not yet implemented.

1985 49-50
1982 62

- Nova Scotia Liquor Commission — recommendations concerning inventory management and space utilization, and also other accounting control and management matters.

Status to be determined at time of next audit.

1984 71

Summary of Previously Reported Recommendations and Observations	Status — at Preparation of 1986 Annual Report	Reference Year	Page
Departmental and Other Audit Observations			
Accounting Function Performance			
Seriously inadequate performance of the accounting function by accounting and management staff of four audit entities in 1982.	Improvements implemented, and acknowledged in 1983 Auditor General Report.	1982	26
Annual Reports of Departments			
Deficiencies in reporting, content and timeliness by several departments, not in compliance with Management Board requirements.	Status to be determined at time of next review of this area.	1983	36
Department of Attorney General			
Concern re increasingly higher level of unpaid fines, and need for more aggressive collection follow-up activities.	Department has initiated several positive steps to address this issue, and continue to pursue unpaid fines actively.	1982 1981	30 27

Cash Losses

- Need for revised Management Manual procedures and responsibilities for dealing with actual or suspected losses.

Not yet implemented.

1985 80
1984 49
1982 19,22
1981 22-23

Computer Related Audits

- Resource management seriously deficient with respect to long range planning and central control structures.

During the years 1983 to 1985 independent studies were commissioned, the EDP Advisory Committee was formed, and formal long range systems planning and approval procedures initiated.

1982 55-56, 60-61

- Need for policies and procedures regarding confidentiality and classification of computerized information.

Procedures have been implemented by Systems and Computer Services Division of Department of Government Services, to handle data in accordance with each department's approvals.

1982 49
1981 30

- Insufficient attention to security and control matters at many installations throughout government.

Although marked improvement in awareness, this is still a continuing concern.

1984 53
1983 34-35

Summary of Previously Reported Recommendations and Observations	Status — at Preparation of 1986 Annual Report	Reference Year Page
• Department of Finance — several control weaknesses in the Department's computer operation.	Corrective action taken by Department on most items where possible.	1982 47-52
• Department of Government Services — Systems and Computer Services Division — on the basis of an extensive audit of SCSD's security policies, procedures and practices, we issued a lengthy report describing 79 major and minor deficiencies.	The Division reacted positively to our observations and recommendations, and took appropriate action to address the deficiencies noted.	1982 48-49 1981 28-29
• Department of Transportation — inadequate segregation of duties in its computer installation.	Comment still applies.	1985 95
Department of Consumer Affairs		
• The Amusements Regulation Board, in contravention of its regulations, was not collecting amusement tax from dance halls, clubs and lounges.	In May 1982 all clubs and lounges were assessed tax, and dance halls exempted.	1981 33-34

Department of Education

- Lack of procedures by the Department to ensure there is adequate fire insurance on school buildings and contents. 1983 38-39

Department of Environment

- Formal policies and guidelines lacking for Environmental Improvement Project grants. 1984 67

Department of Health

- Recommended improvements by the Department's Finance Division in the conduct of their annual audits of hospitals' final settlement claims. 1984 68-69

Department of Housing

- Need for in-depth study to determine extent of future subsidy demands for public and senior citizen housing. 1981 47

Registry of Joint Stock Companies

- Inadequate controls over cash receipts and securities 1983 25

Summary of Previously Reported Recommendations and Observations	Status — at Preparation of 1986 Annual Report	Reference Year	Page
<i>Portland Estates Limited</i>		1985	88
• Shortcomings noted in the administration of the loan to Portland Estates regarding: — receipt and analysis of audited financial statements; and — evidence of payment on an assigned life insurance policy.	Comment still applies. Evidence subsequently obtained.		
<i>Provincial Retirement Plans</i>			
• Teachers' Pension Fund — large and growing unfunded liability; — deficiency in current contributions; — need for actuarial reviews more frequently than every five years.	Comment still applies. Comment still applies. Comment still applies.	{ 1985 1983 1982 1981 }	{ 93-94 44 67-68 48-49 }

Public Service Superannuation Fund	- large unfunded liability, and steps should be taken to freeze it; - current contribution levels should be sufficient to meet costs of benefits gained.	Relatively small increase between 1981 and 1984 actuarial valuations. Currently the contributions are in small excess position.	1985 91-92 1983 44-45 1982 66 1981 48-49
Government Purchasing Agency			
The Government Purchases Act should be amended to alter the Agency's reporting requirement to the Auditor General.		Comment still applies.	1985 63-64
Need for revision to certain of the operating policies and procedures relating to area buying, monthly reporting and the tendering process.		Steps taken to address most of these matters.	1985 65
Department of Tourism — Resort Hotels			
Need for more complete disclosure of the annual operating results of the three hotels.		Department plans to present full cost statement of operating results in its Annual Report.	1985 68
Department of Transportation			
Need to more fully disclose purpose and amount of Special Maintenance Projects program in the annual Estimates.		Expanded description in 1986-87 Estimates, and amounts included as well.	1985 75

Summary of Previously Reported Recommendations and Observations	Status — at Preparation of 1986 Annual Report	Reference Year	Page
<i>Venture Corporations Board</i>			
• Shortcomings regarding information requirements and accounting for investments under the Venture Corporations Act.	Comment still applies.	1985	97
• Lack of compliance by Venture Corporations with information filing requirements of the Act.	Comment still applies.	1985	96
<i>Victoria General Hospital</i>			
• Recommended enhancement of internal audit activity into operational areas.	Comment still applies, in fact this function inactive in 1985 and 1986.	1981	38-39
• Significant weaknesses in financial management relating to: — hospital's financial information system; — organization of function; — lack of a management service function which goes beyond data processing responsibilities; and — administration of the budget process.	Improvements in process. A reorganization effected. To be evaluated at a subsequent audit.	1981 1981 1981	42 40 40
	To be evaluated at a subsequent audit.	1981	41

• Need to negotiate a new contractual arrangement between hospital and Dalhousie University	Fully implemented.	1981	43
• Deficiencies in controls over laboratory revenues	Comment still applies.	1985 1984 1983	96 25 25

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**OFFICE
OF
THE AUDITOR GENERAL**

Office of the Auditor General

Introductory Comments

In my 1985 Annual Report, there were comments regarding the staffing level of my Office. These were in the articles relating to Audit Responsibilities, and the Office of the Auditor General. I expressed concerns regarding the adequacy of resources provided this Office, in order to fulfill our legislated and appointed audit responsibilities.

The Office had experienced considerable delays in receiving approval for and actually filling staff vacancies at the professionally qualified Audit Officer level and above. These conditions remained throughout most of 1985 and the early months of 1986. However, we achieved a full complement status about May 1, 1986, and since then have been close to full staff most of the time. Accordingly, I can report that the concerns expressed a year ago regarding the adequacy of resources are to a large extent now alleviated.

In addition, we have undertaken to depart from a long standing tradition of training students in the professional program for the Institute of Chartered Accountants. Due to the increasing costs, amount of time away from the office principally during the busiest months, and our recent retention experience with newly qualified Chartered Accountants, we have decided to place new students in the professional program of the Society of Management Accountants. The Office has been successful in recruiting professionals who have already attained their designation elsewhere.

This change will increase the amount of time available from students for audit work, and hopefully serve to retain their services for a longer period after professional qualification. It is worth noting that several other Provincial Audit Offices have been or are in the process of shifting certain of their student training to other than the Institute of Chartered Accountants for reasons similar to our own.

In early January 1987, the Office moved to refurbished premises in the same office building. Although the space is marginally less than we had before, a more efficient design provides us with a more functional office facility. We are grateful to all who assisted with the design and the move itself.

Staff Complement

The approved staff complement for the 1986-87 fiscal year was 32, and at the date of release of this Report comprised:

Senior Staff		5
Auditor General, Deputy and Assistant Auditor General, and two Directors		
Audit Teams and Support Staff		23
Audit Managers and Supervisors	7	
Senior Audit Officers with Professional Qualifications	7	
Audit Officers — includes Students and Technicians	9	
Administrative Support Staff		4
		<u>32</u>

The above tabulation reflects staff presently with the Office. However, there are three professionally qualified staff currently on secondment to crown agencies, and for each we have a replacement during the secondment period. We are pleased to have been able to provide these persons to assist the agencies with their accounting and administrative functions. This type of exchange is also of benefit in the professional development of the persons concerned, and I appreciate the opportunity afforded our staff members by these agencies.

Financial

The expenditures and recoveries of the Office for the year ended March 31, 1986, as compared with the approved estimate for the year and the previous year's actual are scheduled below. The net expenditures for 1985-86 are below the approved estimates, because of lower salary expenses attributable to operating for most of the year below the approved staffing complement level.

	Estimate 1985-86	Actual 1985-86	Actual 1984-85
Expenditures			
Salaries	\$1,206,700	\$1,119,499	\$1,021,271
Other	167,100	175,893	131,512
	<u>1,373,800</u>	<u>1,295,392</u>	<u>1,152,783</u>
Recoveries	126,500	87,100	136,200
Net Expenditures	<u>\$1,247,300</u>	<u>\$1,208,292</u>	<u>\$1,016,583</u>

Our budget submission for the 1987-88 fiscal year, which includes a complement of 32 has been approved by Management Board and Executive Council for inclusion in the Estimates to be submitted to the Legislature this spring.

Professional Development and Affiliations

In a professional audit office such as ours, there is a continuing need to maintain a high degree of competence in many areas directly related to the performance of our legislated and other audit responsibilities. These include developments in audit and accounting standards and techniques, contemporary EDP literacy demands which have both audit and administrative ramifications, and an ability to perform assignments which often go beyond the traditional financial statement opinion and compliance audits. As I mentioned last year, there are increasing expectations of Legislative Auditors for greater breadth and depth of audit coverage. In addition, offices such as ours are attempting to function with improved efficiency and productivity.

To meet these challenges and to provide better and more efficient service, we pursue a variety of initiatives. These include membership in professional and other appropriate associations and organizations, active participation in the exchange of information with other Legislative Auditors, the conducting of our own technical seminars and attendance at ones presented by others, and a fair degree of on-the-job training.

One course offering we held in October 1986 is worthy of special mention. It was a course on value-for-money auditing, developed by and presented to us by staff from the Office of the Provincial Auditor of Ontario. In attendance with our own professional staff, were members of the offices of the Auditors General of the other three Atlantic Provinces.

This type of cooperation and interchange is extremely beneficial to a smaller province such as ours, and we are grateful to Ontario's audit office for this worthwhile presentation. Recently we had a senior official from the Federal Auditor General's Office present a session on government financial reporting. We were pleased to invite members of the local university community, and senior staff from many of the local chartered accountants' offices to this seminar.

In addition we have continued our efforts in the area of computer related training from both audit and operational standpoints. In February 1987 we hosted a one day session for the senior staff from each of the Atlantic Provinces audit offices with primary responsibilities in this area.

In common with concerns shared by several legislative audit offices, we have recently reviewed our responsibilities and capabilities with respect to fraud awareness and detection. We have planned a two day seminar for April 1987, to be conducted by the Commercial Crime Division of the R.C.M.P. We have invited staff from the internal audit groups within the Provincial Government, and the other three Atlantic Provinces legislative audit offices.

The purpose of this seminar is not to train our staff to the level of those performing investigative police work. Rather, it is an attempt to enhance our awareness and certain of our audit capabilities, so that we can meet more effectively what I consider to be distinct responsibilities in the area of fraud detection.

In July of 1986 the 14th Annual Meeting of the Canadian Conference of Legislative Auditors was held in Regina, Saskatchewan. This conference is held in conjunction with the meeting of the Provincial and Federal Public Accounts Committees. A joint session is held between both groups during these meetings. The Conference continues to be extremely worthwhile from our point of view, in terms of exchange of information and presentations on relevant topics. In July 1988 Nova Scotia is scheduled to host this joint conference.

An active committee of the Conference of Legislative Auditors is the Legislative Auditors' Practices Committee. This Committee meets annually for the purpose of receiving presentations and discussing matters relating to legislative audit practice, with a prime emphasis on training and educational topics. It was our pleasure to host this meeting in May 1986 for representatives of the 10 Provinces and the Federal Government's audit office.

The Atlantic Provinces Legislative Auditors held their 1986 annual meeting in Fredericton for two days in October. Each of the four Auditors General, together with the Deputies and Assistant Auditors General met to discuss common auditing and administrative matters. These sessions provide the opportunity to delve into items of interest and concern at a different level than the national meetings afford and facilitate a degree of cooperation and interchange in various areas.

We maintain a membership in the Canadian Comprehensive Auditing Foundation. We were represented at the annual conference, and at three of their course offerings held in conjunction with the conference.

The results of the 1986 uniform final examination of the Canadian Institute of Chartered Accountants, announced in December, revealed that three students from our Office were successful in this examination and attained their chartered accountant designation. I was extremely pleased with these results and congratulate the three for demonstrating a dedication, both to their education and audit responsibilities, which has culminated in this achievement.

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APPENDICES

APPENDIX I**The Auditor General Act****Section 7**

The Auditor General shall examine in such manner and to the extent he considers necessary such of the accounts of public money received or expended by or on behalf of the Province, and such of the accounts of money received or expended by the Province in trust for or on account of any government or person or for any special purpose or otherwise, including, unless the Governor in Council otherwise directs, any accounts of public or other money received or expended by any agency of government appointed to manage any department, service, property or business of the Province, and shall ascertain whether in his opinion

- (a) accounts have been faithfully and properly kept;
- (b) all public money has been fully accounted for, and the rules and procedures applied are sufficient to secure an effective check on the assessment, collection, and proper allocation of the capital and revenue receipts;
- (c) money has been expended for the purposes for which it was appropriated by the Legislature, and the expenditures have been made as authorized; and
- (d) essential records are maintained and the rules and procedures applied are sufficient to safeguard and control public property.

Section 8

- (1) The Auditor General shall report annually to the House of Assembly the results of his examination and call attention to every case in which he has observed that
 - (a) any officer or employee has wilfully or negligently omitted to collect or receive any public money belonging to the Province; or

- (b) any public money was not duly accounted for and paid into the Consolidated Fund; or
- (c) any appropriation was exceeded or was applied to a purpose or in a manner not authorized by the Legislature; or
- (d) an expenditure was not authorized or was not properly vouched, or certified; or
- (e) there has been a deficiency or loss through fraud, default or mistake of any person; or
- (f) a special warrant, made pursuant to the provisions of the Provincial Finance Act, authorized the payment of money;

and to any other case that the Auditor General considers should be brought to the notice of the House of Assembly.

- (2) The report of the Auditor General shall be laid before the House of Assembly on a day following the day upon which the Public Accounts have been laid before the House of Assembly.
- (3) Whenever a case of the type described in clause (a), (b) or (e) of subsection (1) comes to the attention of the Auditor General, he shall forthwith report the circumstances of the case to the Minister.

Section 16

- (1) Where the Governor in Council pursuant to this Act or any other Act has directed that the accounts of public money received or expended by any agency of government shall be examined by a chartered accountant or accountants other than the Auditor General, the chartered accountant or accountants shall
 - (a) supply to the Auditor General annually a copy of all financial statements and reports prepared by them relating to the agency of government; and
 - (b) make available to the Auditor General, upon request, and upon reasonable notice, all working papers, schedules and other documentation relating to the audit or audits of the agency accounts.

- (2) Notwithstanding that a chartered accountant or accountants other than the Auditor General have been directed to examine the accounts of an agency of government, the Auditor General may conduct such additional examination and investigation of the records and operations of the agency of government as he deems necessary.

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APPENDIX II

**Audits Performed by Auditor General
In Government Departments*****Agriculture***

Department operations

Attorney General

Criminal Injuries Compensation Board

Department operations

Legal Aid Federal Claim

Legal Aid Trust Fund

Securities Act

Public Utilities Act

Sheriffs' Offices

Consumer Affairs

Department operations

Culture, Recreation and Fitness

Department operations

Development

Department operations

Education

Department operations

Museum claims

School grants

Student Aid

University assistance

Environment

Department operations

Finance

Additional appropriations

Cash and bank controls

Disbursements

Computer Environment Review

Health Services Tax

Payroll

Securities count

Trusts and semi-trusts

Fisheries

Department operations

Government Services

Department operations

Health

Department operations
Hospital construction grants
Payments to institutions

Housing

Department operations

Labour and Manpower

National Training Act claim

Lands and Forests

Department operations

Municipal Affairs

Department operations

Social Services

Canada Assistance Plan claim
Computer environment review
Family benefits
Grants and assistance

Tourism

Department operations

Transportation

Capital equipment inventory
Parts and supplies inventory
Registry of Motor Vehicles
Department revenue systems
Department disbursement systems

Vocational and Technical Training

Vocational Schools

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APPENDIX III**Audits Performed by Auditor General**

Crown Corporations, Boards, Commissions, and Funds

Agricultural Organizations

Provincial Grain Commission
Nova Scotia Crop and Livestock Insurance Commission
Community Pastures Board

Education Institutions

Atlantic Provinces Special Education Authority
Technical University of Nova Scotia

Hospitals

Camp Hill Hospital
Cancer Treatment and Research Foundation of Nova Scotia
Halifax Infirmary
Halifax Infirmary Foundation
Nova Scotia Hospital
Victoria General Hospital

Lending Organizations and Funds

Housing Development Fund
Industrial Expansion Fund
Industrial Loan Fund
Nova Scotia Farm Loan Board
Nova Scotia Fisheries Development Fund
Small Business Development Corporation

Pensions

Members' Retiring Allowance Account
Nova Scotia Teachers' Pension Fund
Public Service Superannuation Fund

Regulatory Bodies

Board of Commissioners of Public Utilities
Nova Scotia Lottery Commission
Public Accountants Board of the Province of Nova Scotia

Other

Atlantic Industrial Research Institute
Canso Superport Limited
Clairtone Holdings Limited
Nova Magnetics Limited
Novaco Limited
Nova Scotia Legal Aid Commission
Nova Scotia Research Foundation Corporation
Nova Scotia Talent Trust
Public Trustee
107375 Holdings Limited

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APPENDIX IV**Audits Performed by Private Sector Auditors**
Crown Corporations, Boards, Commissions and Agencies

Check Inns Limited
Council of Maritime Premiers
Halifax-Dartmouth Bridge Commission
Industrial Estates Limited
Municipal Finance Corporation
Nova Scotia Liquor Commission
Nova Scotia Liquor License Board
Nova Scotia Power Corporation
Nova Scotia Rehabilitation Centre Corporation
Nova Scotia Resources Limited
Schooner Bluenose Foundation
Sherbrooke Restoration Commission
Sydney Steel Corporation
Tidal Power Corporation
Waterfront Development Corporation Limited
Workers' Compensation Board
World Trade Centre Limited

Hospitals

(Agencies as defined in Auditor General Act)

Eastern Memorial Hospital
Eastern Shore Memorial Hospital
Glace Bay Community Hospital
Inverness Consolidated Memorial Hospital
Northside Harbor View Hospital
Strait-Richmond Hospital
Sydney City Hospital
Twin Oaks Memorial Hospital

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